

**United States Agency for International Development
Bureau for Europe and Eurasia**

From Transition to Partnership

**A Strategic Framework for USAID Programs
in
Europe and Eurasia**

December 1999

A Strategic Framework for USAID Programs in Europe and Eurasia

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Executive Summary

The United States has compelling national interests in the political and economic stability of the Central and Eastern Europe (CEE) and Eurasia Region. With the collapse of communism in Central and Eastern Europe in the late 1980s and the break up of the Soviet Union in 1991, the United States began programs of foreign assistance to help foster transition towards democratic institutions and free markets. Since 1989, approximately \$9.4 billion in foreign assistance (exclusive of food aid) has been provided to 27 countries in Europe and Eurasia (E&E).

This paper lays out USAID's framework for future relations with the diverse countries of the Europe and Eurasia region. It will serve as a foundation for more detailed country strategic plans, and for assessing and reporting on the performance of USAID programs.

The vision for E&E Bureau programs is that economic and political transition will culminate in sustainable partnerships between nations, and that this will be further reflected in partnerships among institutions – both public and private – with the U.S. and among E&E countries. USAID programs in economic restructuring, democratic transition, and social transition will contribute to the achievement of this vision and support US foreign policy

objectives in promoting economic and political stability and transition to market democracies.

This strategic framework builds upon lessons learned and insights gained over the past ten years. A number of critical themes are carried forward:

- supporting changes in the role of government in transition countries, to achieve a balance between the functions of government and the freedoms of the private sector and civil society;
- fostering greater participation of the public in the market economy and political institutions;
- preventing and mitigating conflict;
- balancing support for the systemic policy and institutional changes required for transition to a market economy with selective, shorter-term interventions to respond to humanitarian crises and to sustain support for the reform process;
- building institutions for market democracy;
- integrating gender considerations; and
- combating corruption.

At the same time, this strategic framework signals significant changes in emphasis and approach. It recognizes that institutions in many countries have

already undergone extensive transformation over the past decade. In the Northern Tier of the CEE (Poland, Hungary, the Czech Republic, Slovakia, Latvia, Estonia, Lithuania and Slovenia) bilateral assistance programs are ending and new relationships are being defined. In these countries, USAID will foster partnerships and share expertise and best practices through post-presence, "legacy" mechanisms that minimize the use of U.S. Government funds. In contrast, in the countries of Southeast Europe (Romania, Bulgaria, Macedonia, Albania, Bosnia and Herzegovina, Croatia and the Federal Republic of Yugoslavia) and Eurasia (Russia, Ukraine, Belarus, Moldova, Azerbaijan, Armenia, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan) the transition to market-oriented economies and democratic institutions is incomplete. For these countries, USAID plans to address selected constraints to transition, recognizing that the timeframe for assistance will be longer, and the impacts less dramatic, than anticipated at the beginning of the last decade.

Future programs will recognize the critical need to establish and strengthen rule of law, and the growing impatience in many countries with the reform process. Where conditions are favorable, such as in Southeast Europe, regional programs will reinforce ties between countries and promote their closer integration into the world economy.

Social transition issues take on increasing importance as a complement to efforts to foster economic and political reforms. The collapse of old institutions, and the fits and starts of

transition have left greater poverty and hardship than anticipated at the beginning of transition. Political will and popular support for reform were always uneven within the region but have become weaker, in many countries, with the passage of time. USAID has a role to play in bringing the benefits of systemic change to a broader population and helping to improve quality of life. Though limited in terms of resources, USAID programs can play a catalytic role. Improving standards of living of populations in Europe and Eurasia will also help to increase the stability of the region.

Empowering populations and increasing economic opportunity at the provincial and local levels within countries is a major complement to continuing efforts to foster transition at the national level. In many areas, national authorities have adopted *de jure* reforms, but the challenges of implementing reforms carry on to the local level. In other situations, needed changes are not yet feasible at the national level, but work at the local or grassroots level may build demand for future change. Indeed, activities at the local level are often best suited to address the needs of the people of the E&E region.

Overview of the Assistance Environment

Part I of this document highlights the context for assistance to E&E countries. U.S. national interests include: maintaining regional stability -- especially reducing the threat posed by weapons of mass destruction; promoting commercial opportunities and the stability of world markets for oil and

gas; spreading democracy and human rights; responding to humanitarian needs; addressing global environmental and health concerns; and integrating gender considerations.

USAID's Transition Experience

Part II summarizes progress during the first decade of USAID assistance and remaining challenges.

In **economic restructuring**: A number of countries have made notable progress stabilizing their economies; some have posted strong economic growth. Small-scale privatization is well advanced or completed in 22 of 27 E&E countries. Fiscal reforms have improved tax collection in 13 countries and cut fiscal deficits to under 3 percent of GDP in seven countries. Policies, laws and regulatory frameworks for private enterprise have been improved, with ten countries acceding to the World Trade Organization by Fall of 1999. Banking systems in 18 countries have been strengthened in accordance with international standards. Energy prices are at or near full cost-recovery levels in most Northern Tier countries, Romania and Kazakhstan; autonomous energy regulatory agencies have been established in 12 countries. Sound environmental frameworks have been put in place in five countries; and groundbreaking forestry codes have been adopted in Russia.

Remaining challenges include: unfinished reforms – a myriad of policies, laws, regulations and bureaucratic practices still retard private investment and production, and perpetuate both waste and opportunities

for corruption; inefficiencies and market failures in financial services; inadequate preparation for participation in the global market economy; unreformed energy systems, which are a major contributor to many of the region's economic, social and environmental problems; and a legacy of pollution and environmental degradation that threatens social welfare and economic transition in the region.

In **democratic transition**: Generally free and fair elections have been held in 16 countries. An estimated 150,000 non-governmental organizations have been established across the region; they are addressing pressing social, economic, political and environmental issues. Independent media in 13 countries are operating relatively free of government control. Comprehensive frameworks for the administration of justice have been or are being developed in seven countries. Local governments in 11 CEE countries and 6 Eurasia countries have taken steps to become more responsive to the needs of their constituents.

However, in many E&E countries: Further changes are needed in individuals' attitudes and behavior in order to sustain economic and political transition. Democratic processes and civil society organizations are not firmly implanted, and social capital is limited. Independent media face the threat of government interference in many instances, while their financial viability is constrained by weak economies. Limited political will, lack of judicial independence, and corruption are critical obstacles to establishing impartial rule of law. Democratic local governance is in its infancy, and many regional and local

governments operate under severe resource constraints.

In **social transition**: USAID has helped to reduce human suffering for millions of people in times of crisis. Broad-based humanitarian assistance has helped countries to emerge from crises and lay the foundations for their transitions to market democracy. Successful models for reproductive health care services have improved women's health and reduced the prevalence of abortion. Private provision of primary and preventative health services has been demonstrated and, in some instances, replicated through other donor financing. Models for the control and treatment of tuberculosis have been established. Successful HIV/AIDS communication campaigns and partnerships have been undertaken. Frameworks for social insurance and social safety net programs have been tested and established in some countries. Environmental health threats at specific sites have been significantly reduced.

Remaining challenges include: public financing constraints, which limit support for social programs; continuing burdens and risks of humanitarian crises, including complex emergencies caused or exacerbated by conflict; deteriorating health systems and, in many countries, declining health status; containing the spread of tuberculosis and HIV/AIDS; economic conditions and policy constraints that contribute to unemployment, under-employment, and low productivity; pervasive poverty and income inequality which presents an additional burden to governments already struggling to balance their budgets; inadequate and unsustainable

social insurance systems and social safety nets; specific populations vulnerable to violence, exploitation, discrimination, poverty and neglect; and existing education systems that are failing to reach and prepare a growing proportion of the E&E population for participation in emerging market democracies.

Strategic Directions

Part III describes the E&E vision of sustainable partnerships, presents salient implications of lessons learned in the first decade of assistance, and discusses the increasing regional differentiation of programs.

Lessons learned and their implications include:

- Transition requires profound changes, both in individuals' attitudes and behavior, and in institutional capacity. The institutional capacity required to establish and manage the fundamental operations of market democracies was underestimated; in some countries, transition will take longer than originally foreseen.
- Political will and leadership are critical to successful reform; individual participation is also essential to shape and deepen the reform process. USAID can reach out to a broader constituency and help to create consensus on and support for reforms.
- Corruption erodes public support for reform and restrains private sector growth and, thus, foreign investment.
- Establishing rule of law is essential for democratic reforms to take root,

for a thriving private sector, and for effective social programs.

- Social progress has failed to meet the expectations engendered by the shift to market economies, undermining public support for needed reforms; in a number of countries, social conditions have deteriorated.
- Integrating gender considerations throughout USAID's human and institutional reform and development activities will deepen the transition process.
- Small and medium enterprises are increasingly recognized as the most dynamic segment of the private sector.
- Community and regional development approaches are well suited to building cross-sectoral linkages and delivering the benefits of reform directly and tangibly to people.
- Civil war or separatist movements, ethnic violence, crime, and anarchy present unique challenges in the transition to democracy and market-based prosperity.
- Many of the remaining challenges in economic, political and social transition are tightly interwoven. Interdisciplinary approaches are needed to tackle complex issues such as the fight against corruption, social transition, local development, gender equity, and conflict prevention.
- Sharing ideas and experiences within the region can facilitate change as countries confront similar constraints in their transition processes.
- USAID has been successful – and must continue – in coordinating with other US Government agencies and other donors, and in leveraging

billions of dollars, beyond its own resources, for the region.

In the **CEE Northern Tier**, where countries are graduating from bilateral assistance, USAID's "legacy" and regional mechanisms will reinforce the sustainability of results achieved, and promote lasting institutional linkages between countries. In **Southeast Europe**, new regional approaches to achieving stability and reinvigorating economies are being combined with strong, well-focused bilateral assistance programs. In **Eurasia**, bilateral assistance programs are tailored to country-specific transition challenges and to building the institutional capacity for market democracies; as appropriate, USAID also fosters international partnerships benefiting this sub-region. For **common concerns** across the Europe and Eurasia Region, the Bureau will continue to design cost-effective, regional activities to foster information sharing and partnerships.

Strategic Framework

Part IV presents the E&E Bureau's Strategic Framework for 2000 and beyond. In conjunction with the State Department's *Strategic Plan for International Affairs* and USAID's *Strategic Plan*, this framework provides a basis for setting assistance priorities through specific country strategic plans and regional support activities. USAID Missions are expected to tailor and focus their programs in response to the most critical transition issues in their respective countries. The framework is comprised of the E&E Bureau's vision and three strategic assistance areas, with twelve strategic objectives:

Vision for the E&E Region:

To establish sustainable partnerships between the United States and the countries of Europe and Eurasia, between these countries and other regions of the world, and among the countries themselves.

Strategic Assistance Area I -- Economic Restructuring

Goal: *Foster the emergence of a competitive, market-oriented economy in which the majority of economic resources is privately owned and managed.*

- Increased transfer of state-owned assets to the private sector.
- Increased soundness of fiscal policies and financial management practices.
- Accelerated development and growth of private enterprises.
- A more competitive and market responsive private financial sector.
- A more economically sound and environmentally sustainable energy system.
- Increased environmental management capacity to support sustainable economic growth.

Strategic Assistance Area II -- Democratic Transition

Goal: *Foster democratic societies and institutions through empowerment of citizens, independent media, rule of law and good governance.*

- Increased, better-informed citizens' participation in political and economic decision-making.
- Legal systems that better support democratic processes and market reforms.

- More effective, responsive and accountable local governance.

Strategic Assistance Area III -- Social Transition.

Goal: *Enhance the ability of all persons to enjoy a better quality of life within market economies and democratic societies.*

- Strengthened humanitarian response to crises.
- Increased promotion of good health and access to quality health care.
- Mitigation of adverse social impacts of the transition to market-based democracies.

Program Implementation and Performance Measurement

Part V discusses the role of the strategic framework in country programming and program implementation, and performance measurement issues. Additional Management Considerations are addressed in Annex A.

Transition Countries: Europe and Eurasia Regions



From Transition to Partnership

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**I.
Overview**

With the rapid fall of communism nearly ten years ago, the countries of Central and Eastern Europe (CEE)¹ began the transition from command to market-oriented economies and from centralized rule to participatory democracies. Two years later, the republics of the former Soviet Union² embarked on a similar process. Seizing this historic opportunity, the U.S. Congress in 1989 passed the Support for East European Democracy (SEED) Act and in 1992 the

Freedom for Russia and the Emerging Eurasian Democracies and Open Markets (FREEDOM) Support Act (FSA).

Given the range of foreign policy interests in the region, the overall coordination of U.S. assistance policies and programs was placed within the U.S. Department of State. USAID plays a leading role in the planning and implementation of programs to promote economic restructuring, democratic transition and the social dimensions of transition. This paper draws upon the first decade of US assistance to Europe and Eurasia and articulates a vision, guiding principles and strategic objectives for future USAID programs and relationships with host country and international partners in the region. It provides a framework for country-specific strategic planning, resource allocation and program implementation, and for dialogue on experience and shared objectives with countries and partners in the region. USAID uses country-specific programming, supplemented by regional and sub-regional initiatives, to tailor assistance to local needs and priorities, and to integrate U.S. foreign policy concerns.

¹ These countries are composed of two geographical zones. The Northern Tier includes the Czech Republic, Hungary, Poland, Slovakia, Slovenia and the former Soviet Baltic States of Estonia, Latvia, and Lithuania. Southeast Europe (SEE) includes Albania, Bulgaria, Bosnia and Herzegovina, Croatia, Macedonia, Romania, and the Federal Republic of Yugoslavia (Serbia, Montenegro and Kosovo). Note: USAID also provides assistance to Turkey, Ireland and Cyprus focused on economic stability, peace and conflict resolution. While these programs are managed by the E&E Bureau, they are outside the transition strategy presented herein.

² In addition to the Baltic States, these republics include the Russian Federation, Ukraine, Belarus, Moldova, Azerbaijan, Armenia, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan. Formerly referred to as the New Independent States, the E&E Bureau now calls the twelve countries of this sub-region Eurasia.

A. Importance of U.S. Assistance to the Europe and Eurasia Region

The United States has compelling national interests in the political and economic stability of the Central and Eastern Europe and Eurasia Region. U.S. foreign policy interests³ in the region include:

- *Enhancing National Security:* The potential for proliferation or deployment of weapons of mass destruction is an overriding national security concern. Violence and instability in the region (e.g., Balkans, Caucasus) pose real threats to U.S. national security interests. Other concerns include nuclear safety and securing commercial access and viable outlets for the strategically important oil and gas resources of the Caspian region.
- *Promoting Economic Prosperity:* Americans benefit as the economies of nations in transition expand and their markets become more open. Economic restructuring and expansion also help reduce poverty and lack of economic opportunity, which contribute to political instability and exacerbate global and transnational problems. The E&E region covers one-sixth of the globe, spans eleven time zones, and, although it provides less than 5 percent of the world's GDP, holds substantial potential for U.S. investment and trade. U.S. exports to

the region have nearly tripled in the past decade.

- *Strengthening Democracy and Human Rights:* A world of democratic nations provides a more stable and secure global arena in which to advance U.S. objectives and fundamental American values, including the rights of minorities. At the beginning of the decade, the newly emerging nations in the E&E region had little experience with democracy and rule of law. Although important advances have been made across the region, only the countries of the CEE northern tier have democracies close to Western standards. In 1998, the governments of 17 countries in the E&E region were reported as generally not respecting the human rights of their citizens.
- *Responding to Humanitarian Needs:* Since 1989, millions of E&E citizens have been victims of civil conflicts and natural disasters. While the humanitarian situation has improved in many locations, concerns continue in the Balkans, Tajikistan, and the Caucasus.
- *Protecting Health:* Health in the E&E region has profound significance for the well being of Americans as well as the world's population. Unhealthy conditions elsewhere in the world increase the incidence of disease and threat of epidemics which could directly affect U.S. citizens, retard economic progress and increase human suffering. Soviet healthcare was broad but shallow, of low quality, and inefficient. As E&E health

³ U.S. foreign policy objectives are described in the Department of State's *Strategic Plan for International Affairs*, 1997. The Bureau for Europe and Eurasia's Strategic Framework as presented in this paper is fully consistent with USAID's *Strategic Plan*, 1997.

systems deteriorate from inattention and a lack of resources, infectious diseases (such as tuberculosis, and HIV/AIDS) are on the increase.

- *Protecting the Global Environment:* U.S. interests are affected directly by global climate change, loss of biological diversity and pollution, and, indirectly, by conflicts over land, water and other resources. Polluting and unsafe industries were part of the legacy of the Soviet Union's command and control economy. Several of the larger countries in the region (e.g., Russia, Ukraine, Poland and the Central Asian Republics) are priority nations for the U.S. Presidential Initiative in Global Climate Change.
- *Integrating Gender Considerations:* Gender considerations are being integrated into U.S. foreign policy interests and USAID programs to ensure that the United States is promoting equal access and opportunities, equal rights, and equal protection in its assistance programs. Experience suggests that the collapse of communism has had a disproportionate impact on women. Integrating gender considerations will accelerate and deepen the economic and political reform process.

At the inception of U.S. assistance in 1989, programs operated on the premise that a small number of targeted interventions in economic policy reform, coupled with selective support for democracy building, would help move E&E countries far enough along the transition path that they could enter normal economic and political relations

with other countries and complete the journey on their own. Congress and the Administration considered that immediate, on-the-ground impact was essential to influence the direction these newly emerging nations would take. Early expectations were that the duration of assistance to the region would be brief.

While there are many successes as a result of USAID assistance programs -- particularly in the European Northern Tier states -- remaining transition challenges are formidable and fluid. The collapse of the Russian financial system in August 1998 underscored the complexity of the transition task, and conflicts in the Balkans demonstrate how fragile stability can be in this post-Cold War period. Growing differentiation among the countries in how and at what pace transition is proceeding challenges earlier assumptions about the nature and timeframe of the transition process.

Remaining engaged with the nations of Central and Eastern Europe (CEE) and Eurasia is of vital interest to the people of the United States. The greater the degree to which these countries make sustainable progress toward becoming market democracies, the higher the chances are for regional stability and security, enduring links between peoples and institutions, and mutually beneficial economic growth. It remains crucial that the United States continue to help the nations of this region create the necessary conditions for transition so that they may share in a prosperous and peaceful common future.

The long-term vision of USAID's program is for these countries to develop

the sustained capacity to integrate into global markets and organizations and establish enduring economic and political partnerships with the United States and other nations of the world. Building these relationships – at all levels of society -- will contribute to the economic growth and political stability of the region and last long after USAID assistance programs end.

B. Status of the Transition

Figure 1 summarizes the progress of twenty-seven transition countries in democratic and economic reform. The countries are clustered into three groups, reflecting the great variations in transition performance. The most advanced group consists of the Northern Tier. These countries have consolidated reforms and will have graduated from USAID assistance by the end of 2000.

The middle category is a mixed group containing countries that have made significant reform progress and others that have followed an uneven reform process. Eurasian countries in this group include Moldova, Georgia, Armenia, Kazakhstan, Kyrgyzstan, Russia, and Ukraine. In CEE, these countries include most of Southeast Europe: Romania, Bulgaria, Albania, Macedonia, Croatia, and the Federal Republic of Yugoslavia (Serbia, Kosovo and Montenegro). Not yet fully integrated into international economic and political systems, these countries grapple with weak economies, stagnant or declining standards of living, underdeveloped institutions of democracy, and endemic corruption. These conditions have generated widespread apathy toward the reform process and, in some cases, fostered instability and conflict. Most recently,

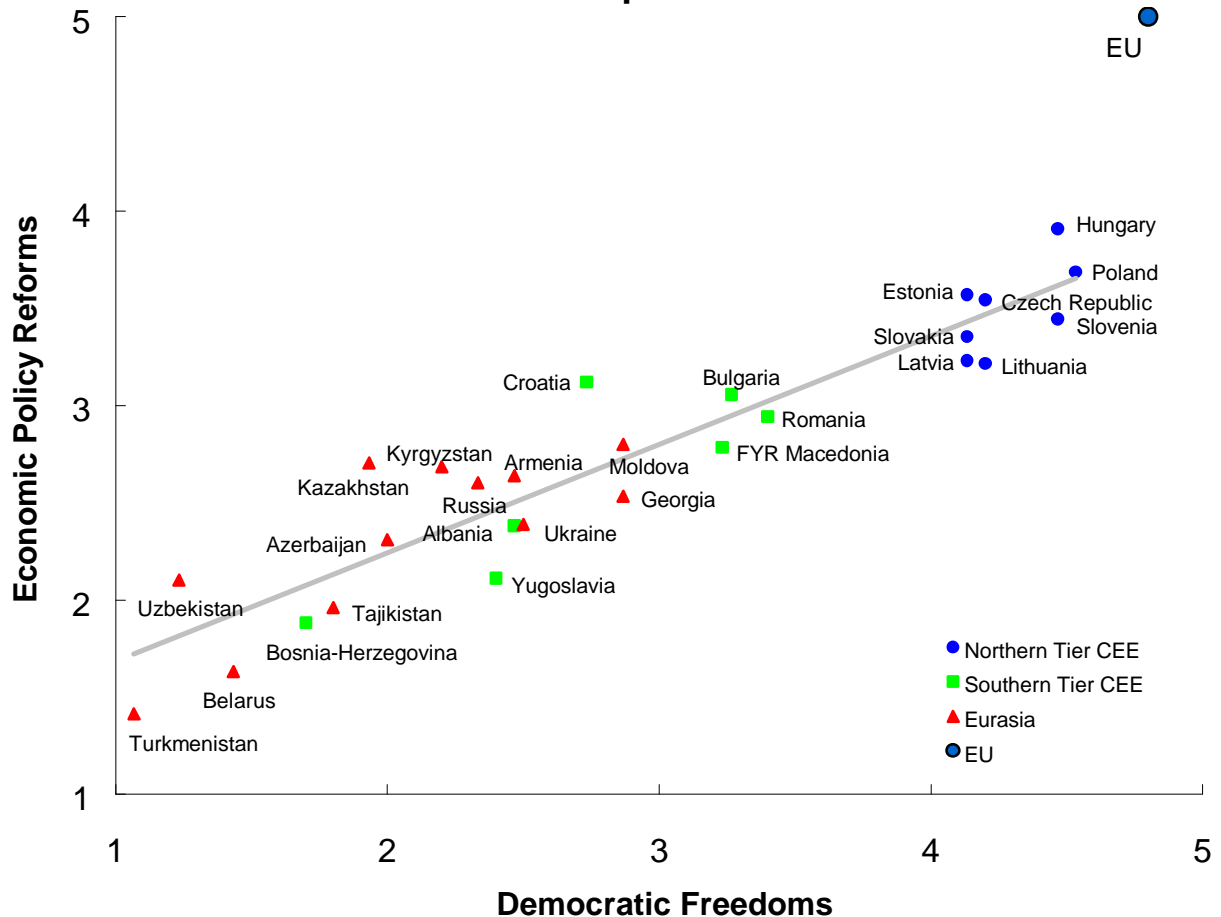
these countries have been plagued by fallout from the Kosovo conflict and from the world financial crisis, their internal reform problems preventing them from adequately weathering these destabilizing events.

Lastly, the group at the lower end of the scale has been much slower in introducing reform, in large part due to autocratic or weak political systems. In Eurasia, these countries are Belarus, Azerbaijan, Uzbekistan, Tajikistan and Turkmenistan, and in the CEE, Bosnia-Herzegovina.

Although, prior to 1989, the people of the region enjoyed universal social benefits, social services were mediocre and systems were largely bankrupt by the time communism collapsed. For example, life expectancy has been falling since the late 1960s, especially for males, in much of the region. Figure 2 shows a positive relationship between economic performance (1998 GDP compared to 1989 GDP) and social conditions in the E&E region (as measured by the *U.N. Human Development Index*). In general, those countries that have advanced a meaningful economic and democratic reform agenda rank relatively high on the Human Development Index. Slowly reforming countries have fared much worse in social measures. The World Bank has noted that in all regions of the world, a country's ability to manage the social costs of structural adjustment has depended significantly on its government's ability to maintain public investments supporting human capital, especially health and education. By this standard, it is not surprising that so many of the E&E countries are suffering from adverse social impacts since spending on

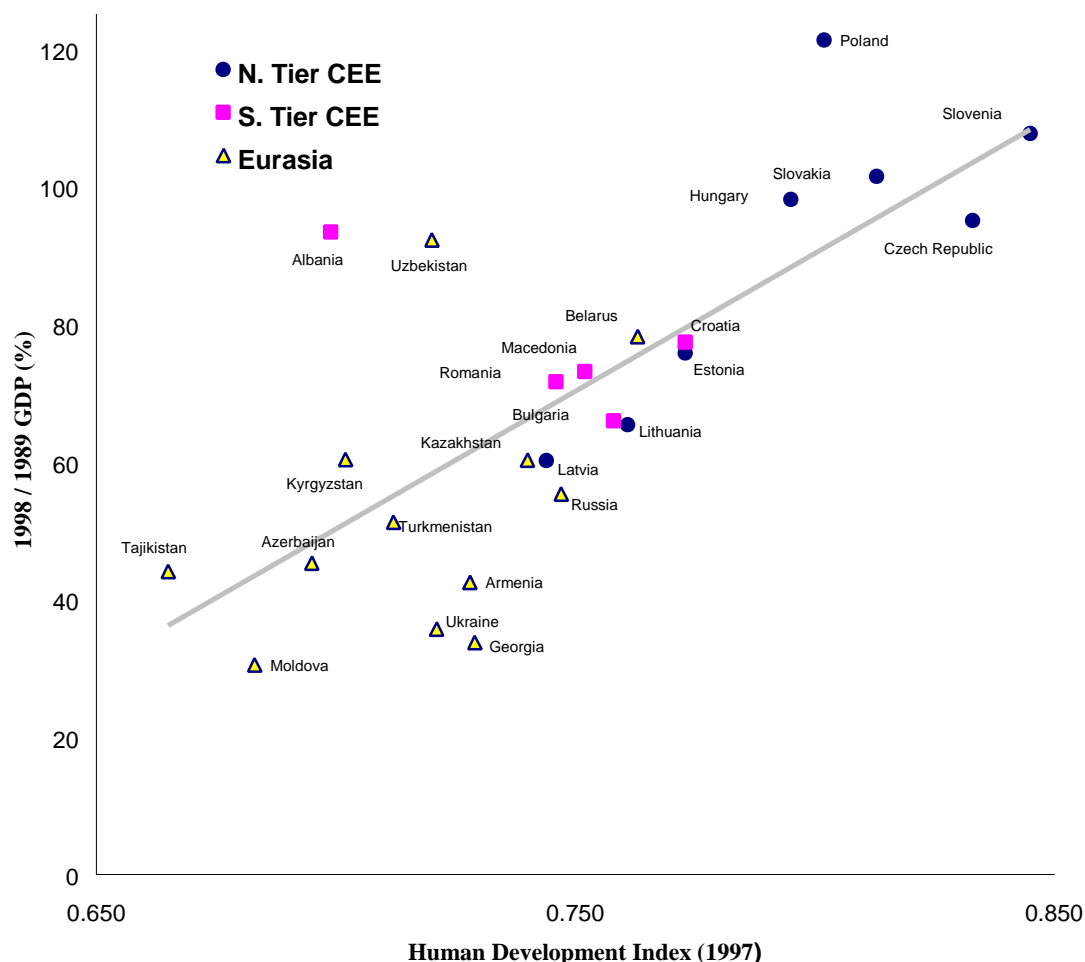
social sectors has declined markedly throughout the region.

Figure 1: Economic Policy Reforms and Democratic Freedoms in Europe and Eurasia: 1999



Note: Ratings of democratic freedoms are from Freedom House, *Nations in Transit 1999* (March 2000, forthcoming) and Freedom House, *Freedom in the World 1999-2000* (May 2000, forthcoming), and assess reforms through December 1999. With one exception, economic policy reform ratings are from EBRD, *Transition Report 1999* (November 1999), and cover events through September 1999; economic policy reform rating for Yugoslavia is from Freedom House (March 2000). Economic policy reforms include price liberalization, trade and foreign exchange, privatization, legal, banking and capital markets, enterprise restructuring (credit and subsidy policy), infrastructure, and environmental policy reforms. Democratic freedoms include political rights (free and fair elections; openness of the political system to competing political parties and to minority group representation; governance and public administration) and civil liberties (free media and judiciary; freedom to develop NGOs and trade unions; equality of opportunity and freedom from corruption). Ratings are based on a 1 to 5 scale, with 5 representing most advanced.

**Figure 2: Human Development and Economic Growth
in the Transition Countries**



Note: The Human Development Index (HDI) is based on three indicators using 1997 data: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy and combined primary, secondary, and tertiary enrollment ratios; and standard of living, as measured by real per capita GDP (\$PPP). The HDI ranges from 0 to 1, with higher values representing greater human development. UNDP, *Human Development Report 1999* (July 1999); EBRD, *Transition Report Update* (April 1999).

C. Transition Trends by Sub-region

The wide divergence in transition progress among E&E countries is attributable to many factors, including historical and institutional patterns, geography (including proximity to the West), intercultural relationships, socio-

economic legacies of the communist system, and current political leadership.

The Northern Tier

The countries of the Northern Tier are widely seen as the most politically and economically advanced of the entire region. The relatively high levels of institutional capacity found in the

Northern Tier – governmental, civic, judicial and financial – have distinguished these countries as regional leaders. The exception has been Slovakia, where until recently, authoritarian leadership blocked meaningful reform. Only since the parliamentary elections of 1998 has a serious commitment to democratic and free-market reforms occurred. The Baltic countries have aggressively pursued their transitions to market democracies, but have been hampered by the legacy of their full incorporation into the Soviet Union and strong, continuing trade links to the East.

Integration with the West is a major impetus for reform. While Hungary, Poland, the Czech Republic, Estonia and Slovenia form the first-round of prospective members to join the European Union (EU) early in the 21st century, other Northern Tier countries are also seeking future membership. All of these countries are graduating from bilateral assistance and moving toward equitable partnerships with the West, although they continue to face a few vulnerabilities in consolidating their transitions to market-oriented democracy.

Political rights and civil liberties in the Northern Tier have improved dramatically over the transition period and are approaching Western levels. These countries enjoy free and fair elections, a healthy political opposition, personal social freedoms, generally independent media, and respect for the rights of most minority groups. Across the sub-region, further reform seems most necessary in government and public administration, in the adoption of anti-corruption measures, and in

promoting equal rights for women. Experience is showing that some post-communist governments in the Northern Tier are instituting new restrictions on long-existing reproductive freedoms for women.

Northern Tier macroeconomic performance has been relatively strong and economic policy reform substantial over the transition period, enabling most of these countries to weather the fallout from the Kosovo conflict and the effects of the global and Russian financial crises. The Baltics, especially Latvia and Lithuania, have been among the hardest hit by the financial crisis as a result of their close trade links with Russia.

For the sub-region as a whole, macroeconomic indicators, such as growth in foreign direct investment (FDI) and private sector output, are largely positive, while inflation has declined steadily. Recent downturns are in most part attributed to the global financial crisis. Further reform is needed in improving corporate governance, capital markets, competition policy, infrastructure and enterprise restructuring. Social conditions have improved over the transition period, though further work lies ahead. Official unemployment averages 9.6 percent, actually lower than in the EU. Poverty rates vary widely and are disturbingly high in the Baltic States, where, on average, nearly 30 percent of the population was living in poverty during the 1993-95 period.

Southeast Europe

Reform progress in Southeast Europe has been halting and uneven despite significant assistance from the

international community. The pace of economic and democratic reform in these countries lags behind Northern Tier neighbors and is, in many instances, similar to transition trends in Eurasia. Most significantly, the countries of Southeast Europe have not overcome a legacy of repression and ethnic discrimination that pre-dates communism. While religious and ethnic conflict was kept in check during the Soviet era, institutional development was held back by the centralized control of Moscow.

With the collapse of communist control, ethnic identities reasserted themselves, resulting in several wars in the former Yugoslavia and threatening stability in the sub-region. Hundreds of thousands of Southeast European citizens are internally displaced or refugees, basic infrastructure is destroyed or in disrepair, and economic production and trade are disrupted. Intensive and prolonged international presence will likely be needed in Bosnia and Kosovo until they can deal effectively with issues of multi-ethnic nation-building and take ownership for their own political and legislative reforms. At present, civil society formation is in its infancy and corruption holds sway in the face of fragile government structures.

Notwithstanding these issues, political freedoms and civil liberties in Southeast Europe have improved since 1991, outpacing Eurasia as a whole. Advances by Bulgaria, Romania, and Macedonia account in large part for improvement in the sub-region's overall profile. All three show strongest progress in the development of political processes, though problems of corruption, governance, and rule of law persist.

Albania has made less progress but has recently adopted a new constitution. In contrast, Croatia has not kept pace in democratization, slowing the country's advancement toward EU integration.

Most Southeast European countries have successfully implemented basic economic policy reforms, including price liberalization and small-enterprise privatization. Yet, all have far to go in creating the competitive business and commercial environments that would substantially increase trade with and investment in these economies. While Croatia has had the strongest economic policy reform standing among Southeast European countries, current macroeconomic trends suggest this is not sufficient to avoid economic troubles. At the other extreme, Albania, Bosnia-Herzegovina and Yugoslavia have the poorest track records, on par with many Eurasian countries.

Since 1994, economic growth for Southeast Europe has not been sustainable given the lack of comprehensive policy reform. The Kosovo conflict is the most recent external shock to affect these economies, reducing 1999 economic growth in all states except Albania. Macedonia, Bosnia, Croatia, Bulgaria, and Romania are likely to be hardest hit, primarily through a loss of trade. Many countries still need to attract foreign investment for sustained economic growth. Fiscal deficits for the sub-region (minus Yugoslavia) on average have been higher than in the Northern Tier. Inflation and fiscal deficits appear to impact investor confidence, as gross domestic investment has declined by 35 percent since 1990 and foreign direct investment has been insignificant

compared to Northern Tier flows. While these countries have largely redirected their trade toward the West, the competitiveness of their export sectors continues to lag. Only Bulgaria, Romania, and Macedonia are on track for early institutional integration with the West. All of these conditions have made handling the impacts of the Kosovo conflict and the Russian financial crisis more difficult.

In terms of social conditions, unemployment is a chronic problem in all Southeast European countries, apparently deepening as more large, state-owned enterprises are privatized or restructured. Income levels in the sub-region are generally closer to Eurasian levels, with Croatia the notable exception. Poverty has increased substantially during the transition, affecting mainly children and the elderly, and registering much higher than in the Northern Tier. On average, one out of every four persons in Southeast Europe was poor in the 1993-95 period, with dramatic increases in poverty occurring in Bulgaria and Romania.

Eurasia

The countries in this sub-region face a broad range of constraints and challenges that render progress toward market-led democracy more complex than was originally anticipated. Those countries that have embarked on economic reform (Russia, Ukraine, Moldova, Georgia, Armenia, Kazakhstan, Kyrgyzstan) have traveled a difficult road. Early macro-stabilization efforts have generally not been followed by the full range of structural and institutional reforms required of a market economy, putting the

sustainability of stabilization measures in jeopardy. In some cases, policy reform efforts have been thwarted either by conservative Parliaments, powerful elites or, where there are progressive lawmakers, by institutions too weak to implement the new laws effectively.

The 1998 world financial crisis had a dramatic impact on Eurasia countries. Russia, unable to sustain high levels of borrowing to cover fiscal deficits for current consumption, experienced the most dramatic setback, with the collapse of its financial system. Most of the other Eurasia countries have incurred high costs as well, due largely to falling prices of commodity exports, close economic ties to a contracting Russian economy, or failed foreign investments in their countries. Despite pre-crisis projections for positive economic growth, output in Eurasia declined by two percent in 1998 and was flat in 1999. High budget and balance of payment deficits and growing inflation have resulted.

In the face of these difficulties, Moldova, Georgia and Armenia are working hard to forge the necessary political consensus for deepening economic policy reforms. Strong executives in Kazakhstan and Kyrgyzstan are pushing ahead with their economic reform agendas. Significantly, Russia and Ukraine have reached serious impasses in furthering their transitions, stifled either by strong opposition forces or unpredictable presidential leadership. Their failure to proceed with broad legal and regulatory reforms has deterred the foreign investment that can play a catalytic role for economic growth. Among the slow reformers, entrenched interests and Soviet-era institutions

endure. Azerbaijan, Belarus, Uzbekistan, and Turkmenistan all resist initiating significant policy reforms. Tajikistan, a case by itself, has demonstrated the will to undertake economic reform but continues to be plagued by civil strife.

In the political sphere, civil society development faces extraordinary challenges after decades of totalitarian rule and amidst bleak economic prospects that constrain the financial sustainability of the non-governmental sector. Since 1991, only Georgia, Moldova and Armenia have witnessed an overall increase in civil liberties and political freedoms. Widespread public corruption, often combined with increased authoritarian tendencies, has contributed to recent backsliding in democracy in Russia, Azerbaijan, Kazakhstan, and Tajikistan.

Social conditions in Eurasia are dismal. Official unemployment persists while average income levels fall. The trends in poverty are also disturbing, with 50 percent of the population living at or below the poverty line, as compared to 10 percent on average in the CEE northern tier. Since 1989, infant mortality rates have increased in many parts of the sub-region, while life expectancy has fallen for the population at large, particularly among males. Overall, the population is aging rapidly. With fertility rates below replacement levels and out-migration of youth, the implications for support of an aging population are significant, particularly in the area of pensions. While large informal economies help individuals cope on a short-term basis, they are inefficient and result in lost fiscal revenues that could support social programs with longer-run impact. These

difficulties, combined with pervasive and visibly corrupt practices, have eroded public support for reform and engendered a deep distrust of institutions – public and private alike.

D. Collaboration with Other U.S. Government Agencies and Assistance Partners

Collaboration with other U.S. Government (USG) agencies, private and voluntary organizations (PVOs), and other donors is essential to maximizing the impact of U.S. assistance in the E&E region. Through inter-agency transfers, other USG agencies participate in complementary technical cooperation programs in the region, including: Department of State on assistance planning, training and exchange programs; Department of Treasury on economic policy; Department of Commerce, Export Import Bank, Overseas Private Investment Corporation and the Small Business Administration on trade, investment and enterprise development; Department of Energy on Global Climate Change and energy reform; Department of Agriculture on food and agriculture; and Department of Justice on criminal law reform including criminal law aspects of corruption.

Private and voluntary organizations are important partners in identifying opportunities to contribute to transition, reaching vulnerable and remote populations, mobilizing resources, and implementing USAID programs. USAID collaboration with PVOs is establishing partnerships, strengthening civil society, delivering humanitarian assistance, and assisting small and micro-enterprises, among other activities.

Principal donor partners include the European Union, the World Bank, and the European Bank for Reconstruction and Development (EBRD), the Asian Development Bank (in Central Asia), the various European bilateral donors, and Japan. Across the region, the United States is the second largest bilateral donor after Germany. Although USAID's financial resources are modest relative to those of the International Financial Institutions, USAID plays an important role as a catalyst, helping to set agendas and leverage multi-lateral, bilateral and private resources. USAID's field presence and ability to make timely technical assistance grants enhances this role.

To further the transition agenda, USAID engages the European Commission regularly, both through annual high level consultations under the New Transatlantic Agenda and through frequent discussions at the country and sub-regional level. On the ground, in-country, USAID has provided leadership in bringing other donors and USG agencies together to promote a shared vision and improve program coordination. USAID's technical assistance programs often set the stage for World Bank and EBRD work in energy, housing, infrastructure, public administration, and economic and social sector restructuring loans. Through pre-feasibility studies and technical assistance to countries in meeting conditions to multilateral loans, USAID has helped leverage hundreds of millions of dollars, *beyond its own contributions*, for the region.

In Bosnia-Herzegovina and Kosovo, the international community [bilateral donors, international financial institutions

(IFIs), international organizations such as the United Nations and the Organization for Security and Cooperation in Europe (OSCE), and the North Atlantic Treaty Organization (NATO)], coordinates closely on implementing peace agreements at a variety of levels. In response to the Kosovo crisis, the international community has signed the *Stability Pact for Southeast Europe*, which provides a broad coordination mechanism to promote regional stability and accelerate the integration of the region into Euro-Atlantic structures. The Southeast Europe "Regional Table" and three separate "working tables" will meet on a variety of issues, including democracy and human rights, economic integration and coordination, and security. A High-Level Steering Group links the results of these working groups to the World Bank and European Union. Membership includes the EU countries, the Southeast Europe states bordering the Federal Republic of Yugoslavia, Russia, Slovenia, the United States, the IFIs, and a variety of other international organizations such as OSCE, OECD, and the Council of Europe.

The Stability Pact is supported by the *Southeast Europe Initiative (SEI)*, which provides practical expression and direction to the U.S. President's policy to further integration, stabilization, and regional cooperation in Southeast Europe in tandem with West European partners. Under the coordination of the U.S. State Department, an SEI Working Group composed of USAID and other USG agencies plans assistance aimed at achieving Stability Pact objectives. USAID directly supports this initiative through activities that promote economic reform, foreign trade and investment, participatory political systems, strong

civil society, and progressive integration into Western political and economic systems.

II.

USAID's Transition Experience: **The First Decade**

A. Programs in Europe and Eurasia

USAID's assistance to the E&E region has had profound impact on transition to market-based democracy, including: growth of private enterprise; increased energy efficiency; democratic elections; establishing foundations for the rule of law; improved local governance; health and social services; and humanitarian relief. The E&E Bureau has adopted criteria to assess performance and gauge readiness for graduation from these assistance programs. Program performance is discussed below, with reference to these criteria (which are elaborated in Annex A).

Through FY 1998, USAID obligated \$9.4 billion of Freedom Support and Support for East European Democracy Act (FSA and SEED) funds -- \$5.7 billion has been provided to Eurasian countries and \$3.7 billion to CEE. While still accounting for the largest portion of assistance, the USAID-managed portion of annual budget appropriations has decreased -- from 74 percent in FY 1996 to 61 percent in FY 1999 -- as transfers to other agencies for energy, security and other programs have increased.

USAID assistance has been allocated to programs in three Strategic Assistance Areas (SAA): Economic Restructuring (including Energy and the Environment); Democratic Transition; and Social Transition. In addition, USAID administers Special Initiatives and Crosscutting programs, including Enterprise Funds, training and exchanges, selected activities in

reproductive health and infectious diseases, and small grants to grassroots organizations in support of transition objectives across the portfolio. These assistance programs in the E&E region are fully consistent with USAID's Strategic Plan (see Box 1).

Box 1: Agency-wide Program Goals

- Broad-based Economic Growth and Agricultural Development Encouraged.
- Democracy & Good Governance Strengthened.
- Human Capacity Built Through Education and Training.
- World Population Stabilized and Human Health Protected.
- The World's Environment Protected for Long-term Sustainability.
- Lives Saved, Suffering Associated with Natural or Man-made Disasters Reduced, and Conditions Necessary for Political and/or Economic Development Re-established.

Source: *USAID Strategic Plan*, September 1997 (revised 1999).

B. Progress to Date and Remaining Challenges

1. Economic Restructuring

The goal of Strategic Assistance Area I is *to foster a competitive, market-oriented economy in which the majority of economic resources is privately owned and managed*. This assistance has been provided under the rubric of six strategic objectives:

- Increased transfer of state-owned assets to the private sector.
- Increased soundness of fiscal policies and fiscal management.
- Accelerated development and growth of private enterprises.
- A more competitive and market responsive private financial sector.
- A more economically sound and environmentally sustainable energy system.
- Increased environmental management capacity to support sustainable economic growth.

Through FY 99, 62 percent of assistance has supported economic restructuring programs.

Highlights of USAID's Contributions to Economic Restructuring

At the collapse of communism, economic systems throughout the E&E region were inefficient and unable to meet the needs or advance the aspirations of the people in the region. Over the past ten years, progress has varied across and within countries:

A number of countries are now on a firm path of economic growth, despite the setbacks of the recent financial crisis. Poland, Hungary, Estonia, Slovakia, Slovenia and Armenia, in particular, have posted strong economic growth in recent

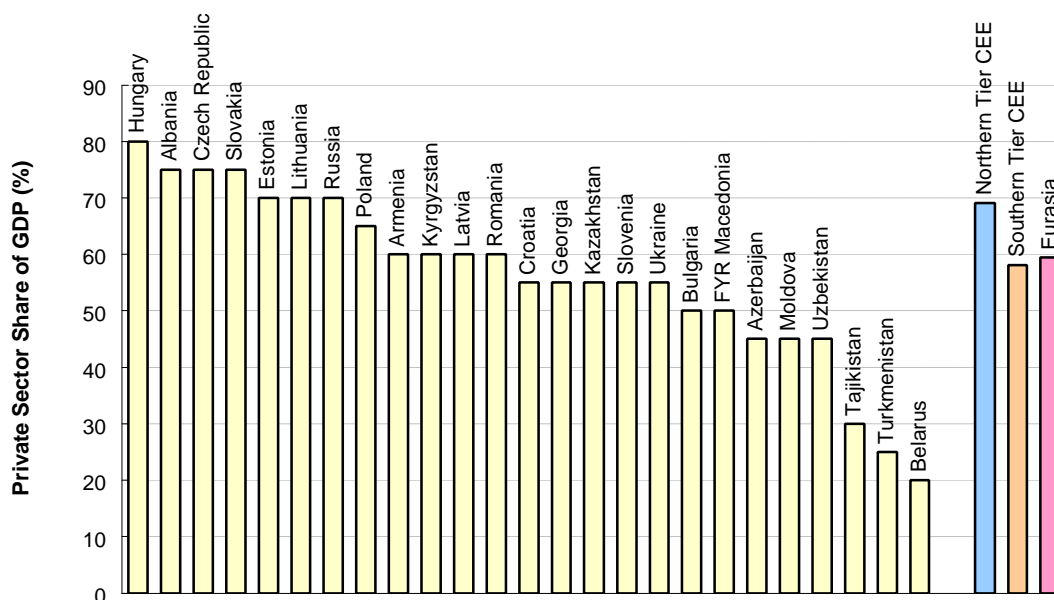
years. E&E countries have made progress in stabilizing their economies, notably Estonia, Latvia and Slovenia. All but a few countries have liberalized their economies, setting the stage for future growth. More than 700,000 people (nearly 40 percent of whom are women) have received training linked to USAID's economic restructuring programs.

Partnerships supportive of economic restructuring have been established between institutions in E&E countries and the U.S. Upwards of 700 partnerships have been formed between the U.S. and institutions in the E&E region, including trade and professional associations, business support groups, universities, banking and lending institutions, and agricultural and rural associations.

Increasing private ownership of businesses and property, including land and housing, is transforming the E&E region. For instance, privatization of small enterprises is well advanced or completed in 22 of 27 E&E countries. These reforms have contributed to increases in productivity, growth in service sectors, and reductions in government subsidies to enterprises. Overall, the private sector accounts for more than 50 percent of GDP in the E&E region (Figure 3), compared to 13 percent in 1990; 65 percent of recorded employment is in the private sector, compared to virtually none in 1989. USAID, the World Bank and the EBRD are the major donors supporting privatization in the E&E region.

Fiscal reforms have been put into place. Considerable progress has been made in reforming tax policies, improving tax administration and strengthening the formulation and execution of budgets, especially in the Northern Tier. As a result, over the past three years, tax collection has improved in 13 E&E countries, and seven

**Figure 3: Private Sector Share of GDP:
Transition Countries of Europe and Eurasia**



Source: European Bank for Reconstruction and Development, *Transition Report* 1999, November 1999.

countries have cut fiscal deficits to below 3 percent of GDP. In several countries, reforms in pension systems are well under way, and pilot activities to enhance the authority of regional and local governments to manage finances have been initiated. USAID has provided assistance for fiscal reform to 22 countries.

The policy, legal and regulatory framework for private enterprise has improved, in most E&E countries, though much more needs to be done. Ten countries -- Bulgaria, Czech Republic, Estonia, Georgia, Hungary, Latvia, Poland, Slovakia, Slovenia, and Kyrgyzstan -- have joined the World Trade Organization as of Fall 1999. Improved commercial laws are on the books in most E&E countries, though implementation and enforcement is spotty. Progressive bankruptcy codes have been adopted in Bulgaria, Kazakhstan and Romania. Direct

and portfolio investment has responded to the improved business climate in many countries, despite the significant setbacks of 1998. With USAID assistance -- including credit, skills and technology transfer -- small and medium enterprises are leading private sector growth. For instance, over 250,000 firms have been assisted in adopting International Accounting Standards. Women head one-third of new small businesses.

USAID assistance has contributed to the development of banking systems in 18 countries. Banks have been privatized, improved legal and regulatory frameworks are in place, bank regulatory authorities have been strengthened, and International Accounting Standards introduced into banking. Northern Tier countries have made the most progress. In Eurasia, Kyrgyzstan and Moldova are on the verge of meeting

international prudential standards. USAID assistance for development of capital market infrastructure and improved regulatory authorities has contributed to growth in market capitalization.

Energy sector reforms have been adopted. Energy prices are now at or near full cost-recovery levels in most Northern Tier countries, plus Romania and Kazakhstan. Substantial cooperation in energy systems' planning and operations is taking place among Baltic countries and among Hungary, Poland, Czech Republic and Slovakia. Twelve countries in the E&E region have established autonomous energy regulatory agencies. Eleven major power systems have been demonopolized and eleven separate energy companies have become more politically independent. Assets valued at over \$4 billion have been privatized in Russia, Czech Republic, Hungary and Kazakhstan. Nuclear reactors have been upgraded in Bulgaria, Lithuania, Russia and Ukraine. Ukraine has entered into a Memorandum of Understanding with donors on decommissioning the Chernobyl nuclear reactors. USAID, World Bank, EBRD, European Investment Bank, and European Union have been the principal donors for energy restructuring.

Management of environmental resources has improved. Sound environmental frameworks have been put in place in Estonia, Hungary, Poland, Romania and Slovakia. Kazakhstan has committed to reducing greenhouse gases and acceded to the Framework Convention on Climate Change. Groundbreaking forestry codes have been adopted in Russia. Environmental funds are sustained by fines and fees from the public and private sectors in several countries. In some countries – notably Poland and the Czech Republic – these funds have produced unprecedented levels

of investments in environmental improvements. The Central Asian Republics have adopted water sharing agreements and put in place representative water-user associations, laying the groundwork for sustainable water management. USAID support for the environment is coordinated with other partners, including the EU and European bilateral donors.

In spite of the successes noted above, a comparison of E&E country performance (Table 1) underscores the fact that economic transition will be a long-term process in Southeast Europe and Eurasia. The criteria used for comparison have been developed to assess each country's readiness for "graduation" from bilateral USAID assistance (see Annex B). The Northern Tier countries are well advanced with respect to these strategic objectives, although fiscal and energy sector reforms are incomplete. An additional eleven countries have made significant steps in economic restructuring. Kazakhstan, Kyrgyzstan, Moldova, Russia, Ukraine, and, more recently, Armenia and Georgia show greater transition progress than other Eurasian countries. Seven countries lag in their economic restructuring programs.

Remaining Challenges in Economic Restructuring

Inefficient or non-sustainable allocation of productive resources, low levels of investment, slow and inconsistent economic growth, and poor fiscal performance still plague the majority of the E&E countries. Economic restructuring is constrained by poor policies, limited adherence to the rule of law, weak human capital, poor infrastructure and environmental problems. In 15 of 27 E&E countries, GDP in 1998 was below 75 percent of the levels attained in 1989 (see figure 2). Poverty persists; over

**Table 1: Readiness for Graduation from USAID Assistance:
Summary Of All E&E Countries For Economic Transition Strategic Objectives**

	Economic Restructuring and Growth						SO#	Statement of Objective
	1.1	1.2	1.3	1.4	1.5	1.6		
Slovenia	⊙	⊙	⊙	⊙	□	⊙	1.1	State-owned assets are being transferred to the private sector at acceptable rate
Hungary	⊙	⊙	⊙	⊙	⊙	⊙		
Poland	⊙	⊙	⊙	⊙	⊙	⊙		
Czech Republic	⊙	⊙	□	⊙	⊙	⊙	1.2	Fiscal policies and management are sound
Estonia	⊙	⊙	⊙	⊙	⊙	⊙		
Lithuania	⊙	⊙	⊙	⊙	⊙	⊙	1.3	Private enterprises are growing and developing at an accelerating rate
Latvia	⊙	⊙	⊙	⊙	⊙	⊙		
Slovakia	⊙	⊙	⊙	⊙	⊙	⊙		
Croatia	⊙	⊙	⊙	⊙	□	⊙	1.4	The private financial sector is increasingly competitive and market responsive
FYR Macedonia	⊙	⊙	○	⊙	⊙	⊙		
Romania	○	○	⊙	⊙	⊙	⊙		
Bulgaria	○	○	⊙	⊙	○	⊙	1.5	The energy sector is economically sound and environmentally sustainable
Moldova	○	○	○	⊙	⊙	⊙		
Russia	⊙	○	○	○	○	⊙		
Georgia	⊙	○	⊙	○	○	○	1.6	Environmental management capacity supports sustainable economic growth
Kazakhstan	⊙	○	⊙	○	⊙	○		
Kyrgyzstan	⊙	○	⊙	○	○	○		
Ukraine	○	⊙	○	○	○	⊙		
Albania	○	○	○	⊙	○	○		
Armenia	○	○	⊙	○	○	○		
Bosnia-Herzegovina	○	○	○	○	□	○		
Uzbekistan	○	⊙	○	○	□	○		
Azerbaijan	○	○	○	○	□	○		
Belarus	○	○	○	○	□	○		
Tajikistan	○	○	○	○	□	○		
Turkmenistan	○	○	○	○	□	○		
F.R. Yugoslavia	□	□	□	□	□	□		

⊙ Country has largely met this strategic objective

⊙ More time is needed before reforms are sustainable

○ Reform efforts in this SO have been slow or non-existent

□ Ratings not available for this country/SO

Source: *Readiness for Graduation from USAID Assistance*, USAID/ENI, February 1999.

168 million people in the region still live on less than \$4.00 per day. In 11 of 27 countries, officially reported unemployment exceeded 10 percent of the labor force between 1996 and 1998. Since 1989, income inequality has grown in all countries for which data are available, except Hungary. Romania, Russia, Kyrgyzstan and Ukraine experienced the greatest increases in inequality between 1989 and 1996. Rampant corruption and waste must be brought under control, to attract foreign investment and to ensure that the people of the region realize the benefits of economic restructuring.

Economic restructuring is unfinished. A myriad of policies, laws, regulations and bureaucratic practices retards private investment and production, and perpetuates both waste and opportunities for corruption. Even where reforms have been adopted through legislation or decree, implementation frequently falls short. In many countries, the state still controls substantial productive assets and factors of production. In particular, the privatization of larger, strategic enterprises is not far advanced and has significant social implications. State ownership or management control of enterprises and land discourages private initiative and competition, and retards economic growth. This state ownership, combined with onerous tax rates and arbitrary behavior of tax authorities, holds down tax revenues while encouraging tax evasion, distrust, and inadequate exchange of economic information. Throughout the region, additional reforms are necessary to: eliminate destabilizing budget deficits; improve the conditions for private sector growth; establish accountability and transparency while reducing

opportunities for corruption; rationalize and fulfill the social responsibilities of the state, including sustainable financing of social services and pensions; and provide a fiscal framework supportive of governmental decentralization.

Excessive regulation and the lack of information and transparency feed corruption and raise the costs of doing business. Institutions required for transition to a market economy are typically weak. There is a lack of commitment to and experience with effective rule of law by E&E states and their citizens. Further work is needed: to develop the capacity of governments to facilitate and regulate private enterprise and public utilities; to improve political oversight of regulators; to stimulate constituents to participate in the economic policy process and hold politicians accountable for their actions; and to enforce and adjudicate contracts.

Inefficiencies and market failures in financial services must be addressed in most countries. Financial systems play a catalytic role in economic growth. Yet, in most of the region, they still fail to mobilize and allocate capital effectively. Further work is needed to reduce state ownership of banks, build institutions, strengthen regulation of banks and capital markets, and develop new financial instruments.

Private enterprise is inadequately prepared to fulfill its potential in the global market economy. USAID's work with private enterprises indicates that there are still significant gaps in management skills, technological capabilities and market information. New investment is required and resources must be used more

productively. Many countries suffer from inefficient and deteriorating physical infrastructure, and systems for supplying inputs and for collecting and distributing products have collapsed. This contributes to reduced earnings and decreased demand for inputs. In most of the region, private markets have yet to emerge to fill this void. Indigenous capacity to address these constraints varies by country, though, generally, the organizational and financial capacity of trade and professional associations remains weak. Countries generally lack the information technology needed to attract foreign investment and access global markets.

Unreformed energy systems are a major contributor to many of the economic, social and environmental problems encountered today in the E&E region. Energy production, distribution and consumption are wasteful. Inefficiencies raise costs, result in intermittent service, contribute to governments' fiscal deficits, and, in many countries, add to trade deficits. Moreover, hospitals, schools and vulnerable populations are subject to service cutoffs. In Eurasia, energy systems are plagued by serious financial weaknesses and non-payments problems. Development of functioning electricity markets, strategic privatization of energy companies, and, where incomplete, regulatory reform are important challenges for the future. In addition, nuclear safety remains a major concern in Russia, Ukraine, Armenia, Lithuania and Bulgaria.

There is a legacy of pollution and environmental degradation that must be addressed throughout much of the E&E region. The problems have economic costs, for instance, through adverse

impacts on investment and productivity. However, environmental management capacity and financial resources to address these concerns are severely constrained. In Eurasia, substantial reforms are still needed in the legal, regulatory and policy frameworks on environmental issues. Where sound environmental laws are on the books, enforcement remains a major challenge.

2. Democratic Transition

The goal of Strategic Assistance Area II has been: to *support the transition to transparent and accountable governance and the empowerment of citizens through democratic political processes.* SAA II is comprised of three strategic objectives:

- Increased, better-informed citizens' participation in political and economic decision-making.
- Legal systems that better support democratic processes and market reforms.
- More effective, responsive and accountable local government.

Through FY 1998, about 11 percent of USAID resources to the region have supported programs in civil society development, rule of law, and local government strengthening.

Highlights of USAID's Contributions to Democratic Transition

In 1989, democratic institutions were essentially non-existent at the national or local levels in E&E countries, nor did citizens enjoy basic democratic freedoms, such as the right of free expression, the right to organize and advocate for their interests, and the right

to form independent political parties and hold free elections. Significant results have been achieved, although the transition process is far from complete.

USAID has helped to establish democratic electoral processes. Generally free and fair elections have been held in 16 countries in the region, although there have been instances of flawed procedures and other campaign violations. Even where electoral processes are weak, political parties may have been active. To date, two or more national political parties have participated in national elections in 18 countries. Activists in over 80 political parties throughout the region have received training in election campaign techniques, voter education, and election monitoring. Election commissions exist in 20 countries, although over half of these require further institutional strengthening. US private and voluntary organizations have implemented USAID-funded electoral support activities in 22 countries.

Non-governmental organizations are advocates for and providing services to growing numbers of people in the region. An estimated 150,000 Non-Governmental Organizations (NGOs) now exist across the region and are addressing pressing social, economic, political and environmental issues. Supportive legal and regulatory frameworks for NGO development have been established – or are in the process of being established -- in fourteen countries. In the Northern Tier, where there is some past history in civil society, NGOs are rapidly becoming an important part of the social fabric, providing necessary services, participating in public policy debates on

a variety of significant economic and social policy issues, and contributing to the democratic political process. In Southeast Europe and Eurasia, NGOs are less mature, but are making steady progress, despite unfavorable economic, legal, and administrative conditions. USAID has been a leader in NGO strengthening.

Media independence has increased. Seven countries, all in Europe – Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Slovenia -- have media legislation that conforms to EU standards, while another nine countries have adequate legislation covering the media sector; however, the rule of law is not yet firmly enough established in these countries to ensure the proper execution of the legislation's intent. Independent media in thirteen countries are operating relatively free of government control. In Bosnia, Croatia, Serbia, and most of Eurasia, media independence is threatened, with instances of serious government repression in Serbia, the Republika Srpska in Bosnia, Belarus and Turkmenistan. In Russia's regions, 40 percent of viewers watch independent television, compared to only 25 percent as recently as 1998. More than 10,000 media professionals from E&E countries have been trained in management and objective, fact-based reporting. USAID is the major international donor assisting the independent media in the E&E region.

Significant legal system reforms have been approved. In the early years of the transition, parliamentary exchanges, training and technical assistance were instrumental in orienting new E&E parliaments to enact economic and

political reforms, civil liberties laws and new constitutions. Ongoing institutional support to legislatures focuses on the transparency of the law-making process, ensuring greater legitimacy and acceptance for new laws. Comprehensive frameworks for the administration of justice have been or are being developed in Armenia, Bosnia and Herzegovina, Bulgaria, Georgia, Moldova, Russia, and Slovakia. Judges and lawyers are being empowered through training and associations to work toward independence of the judicial system, thereby helping to create checks and balances against the arbitrary power of political leaders and state bureaucracy. Over 7,500 judges, academics and legal professionals from 22 countries have been trained. Georgia and Armenia are implementing merit-based selection processes for judicial candidates – a significant milestone in creating an independent judiciary and promoting the rule of law. USAID and the World Bank are the major donors supporting legal system reforms.

Local governments have received greater authority and independence from the center. USAID's local governance programs in eleven CEE and six Eurasian countries are helping local governments become more responsive to the needs of their constituents, more transparent in budgeting and decision-making, and more accountable in procedures and service delivery. At the national level, USAID has supported policies and laws that devolve administrative and fiscal authorities to the local level. At the local level, training and capacity building are resulting in more professional operations and improved services. Strengthened municipal associations – which operate

within most countries in the region – are better representing local interests at the central government level. In cooperation with development partners, USAID is promoting the Local Government Information Network (LOGIN) which disseminates information on best practices in local governance to local authorities in the region. The prospect of membership in the European Union has acted as a powerful incentive for government decentralization and strengthening local government capacity in Northern Tier countries.

Table 2 shows country progress with respect to democracy and governance graduation criteria. The eight Northern Tier countries are at or near graduation thresholds for their respective democracy and governance strategic objectives. Eleven countries have registered significant progress with respect to at least two of the three democracy and governance objectives. Bosnia, Azerbaijan, Belarus, Tajikistan, Turkmenistan and Uzbekistan face significant challenges on the democratic transition path.

Remaining Challenges in Democratic Transition

Transition to participatory democracy, rule of law and local governance is incomplete in much of the E&E region. Although democratic transition is well advanced in the Northern Tier, ethnic and religious conflict, weak states, authoritarian governments and human rights violations are in evidence in a number of Southeast European and Eurasian countries.

**Table 2: Readiness for Graduation from USAID Assistance:
Summary Of All E&E Countries For Democratic Transition Strategic Objectives**

	Democracy & Governance			SO#	Statement of Objective
	2.1	2.2	2.3		
Slovenia	□	□	□	2.1	Informed citizens participate actively in political and economic decision-making
Hungary	⊙	⊙	⊙		
Poland	⊙	⊙	⊙	2.2	Legal systems support democratic processes and market reforms
Czech Republic	⊙	⊙	⊙		
Estonia	⊙	⊙	□	2.3	Local government is effective, responsive, and accountable
Lithuania	⊙	⊙	□		
Latvia	⊙	⊙	□		
Slovakia	⊙	⊙	⊙		
Croatia	⊙	⊙	□		
FYR Macedonia	⊙	⊙	○		
Romania	⊙	⊙	⊙		
Bulgaria	⊙	⊙	⊙		
Moldova	⊙	⊙	○		
Russia	⊙	⊙	□		
Georgia	⊙	⊙	□		
Kazakhstan	⊙	○	○		
Kyrgyzstan	⊙	⊙	○		
Ukraine	⊙	⊙	○		
Albania	⊙	⊙	○		
Armenia	⊙	⊙	○		
Bosnia-Herzegovina	○	⊙	□		
Uzbekistan	○	○	□		
Azerbaijan	○	○	□		
Belarus	○	○	□		
Tajikistan	○	○	□		
Turkmenistan	○	○	□		
F.R. Yugoslavia	□	□	□		
⊙ Country has largely met this strategic objective ⊙ More time is needed before reforms are sustainable ○ Reform efforts in this SO have been slow or non-existent □ Ratings not available for this country/SO					

Source: *Readiness for Graduation from USAID Assistance*, USAID/ENI, February 1999.

Further changes are needed in individuals' attitudes and behaviors in order to sustain economic and political transition. Social capital -- formal and informal institutions, relationships and

norms that promote cooperation in society -- is limited throughout much of the E&E region. This is demonstrated by lack of trust among different segments of society, weak civil society institutions,

lack of respect for the rule of law, and obstacles to conducting business.

The sustainability of democratic political processes and civil society organizations has not yet been achieved throughout the E&E region. Consequently, citizens are not fully effective in holding governments and economic elites accountable. While most E&E countries have track records of free and fair national elections, political parties' development tends to be limited. Civil society organizations are growing rapidly in numbers and capacity, but they are starting from a very limited base. Typical problems include government interference, lack of financial viability, poor organizational management, lack of public awareness, and failure to effectively serve or represent constituents and clients. USAID has played an important role in the development of the NGO sector, even in those countries where the political environment constrains progress. As demonstrated in Slovakia by the OK 98 NGO Coalition -- which supports voter education and outreach, and civic education -- assistance to civil society under these circumstances can provide a significant counter-balance to the growing centralization of power in the more recalcitrant states. However, experience also suggests that institutionalizing a strong civil society will take a very long time in many E&E countries.

Media independence is far from assured, especially in Southeast Europe and Eurasia. In several countries, including Albania, Belarus, Bosnia, Serbia and Turkmenistan, media independence is not yet firmly established in law. In others, laws are selectively enforced, and government interference remains a

significant problem. In Eurasia, many media outlets face an additional burden: economic conditions limit the financial viability of their operations; the public cannot afford to pay and advertising revenues are weak, especially in the wake of the financial crisis. Also in Eurasia, more training is needed for the media in basic journalism, business and management skills.

Strengthening the rule of law is a long-term process, with critical obstacles to reform including limited political will, lack of judicial independence, and corruption. USAID's experience in the countries of Europe and Eurasia demonstrates that establishing impartial rule of law is a long-term process, with progress requiring significant political and cultural will to reform. The enactment of legislation is only an early step in the reform process; implementation, acceptance and enforcement of laws requires additional time and support. Because corruption has such a corrosive impact on both nascent and more-established reforms, affecting citizen confidence in legal systems and the material benefits of reform, anti-corruption assistance is key. Certain countries -- Azerbaijan, Belarus, Kazakhstan, Tajikistan, Turkmenistan, and Uzbekistan -- have lagged both in establishing independent judiciaries and in providing support for human rights. Given the limited opportunities for rule of law reform in these countries, USAID assistance focuses more on strengthening electoral processes, independent media, and civil society.

Democratic local governance is in its infancy in a number of countries. Even in those countries where decentralization has been approved through new

legislation, actual devolution -- including local selection of leaders, and true administrative and fiscal authorities -- is quite limited. Most regional and local governments operate under severe resource constraints. In addition, particularly in Eurasia, the capacity of local governments to administer resources effectively and transparently is weak; to the extent that authority has been devolved to the local level in these countries, it has often been by default as the center abandoned its former responsibility to provide a large social safety net to citizens. Moreover, the quality of locally provided, basic services, such as heat, water and sewerage, electricity and gas, and housing, remains poor in most of the E&E region. As private markets take root, local governments must streamline and reorient themselves to function as facilitators and regulators of private development and business activity.

3. Social Transition

The goal of SAA III has been to reform health and human services to address the needs of societies in transition to market-based democracies. To date, SAA III has been operating under two strategic objectives:

- Improved response to and management of humanitarian crises.
- Improved sustainability of health and social benefits and services.

Through FY 1999, nearly 20 percent of USAID resources to the region have supported humanitarian assistance needs (including the total budget for Bosnia as well as crisis situations in other E&E countries). An additional 7 percent of funding to the CEE and Eurasia has been

devoted to targeted interventions in health care and social benefits reform. Early in the program, activities under this rubric also addressed environmental risks to public health.¹

Highlights of USAID's Contributions to Social Transition

USAID has helped to reduce human suffering due to crises. Emergency food, shelter, fuel and medical supplies provided to the Balkans, Caucasus and Tajikistan have helped several million people (families displaced by ethnic strife, infants, pregnant and lactating mothers, pensioners) survive crisis situations over the past decade.

Broad-based humanitarian assistance has helped countries to emerge from crises and to lay the foundations for their transitions to market democracy. USAID-supported micro-projects in Armenia, Azerbaijan, Tajikistan and the Balkans have assisted thousands of communities to repair infrastructure, increase economic activity, and to learn about basic democratic principles and practices. In Bosnia-Herzegovina, for instance, hundreds of municipalities show signs of normalization as schools are rehabilitated, power and water systems are renewed, and health facilities are repaired. Reconstruction activities have created short-term jobs and employed thousands of demobilized soldiers. At the same time, support for business development and bank training has strengthened hundreds of companies and substantially expanded employment opportunities. At least 250 national

¹ An additional strategic objective for environmental health (SO 3.3) was phased out beginning with the introduction of SO 1.6 for environmental management in FY 97.

NGOs operate in Bosnia today, providing trauma counseling and other basic assistance needs once handled by the international PVO community. This emerging network of local NGOs strengthens the development of civil society and contributes to the rule of law. Simultaneously, a growing independent media sector offers consistent and objective news.

Successful models for reproductive health care services have been developed. From their recent Soviet past, women throughout the E&E region have relied on abortion as the primary method of controlling family size. This has led to high rates of maternal morbidity and mortality. Since 1991, USAID has funded programs to promote access to and knowledge of modern methods of contraception. These programs have contributed to significant decreases in abortion rates, especially in Kazakhstan, Uzbekistan, Kyrgyzstan and Russia. Effective mass media programs, curriculum development in medical schools, training for thousands of health care providers and pharmacists, development of health education programs for youth, and the establishment of 12 Women's Wellness Centers through the hospital partnership program have all helped contribute to this decline and to improving maternal and child health overall.

Private provision of health services has been demonstrated through USAID activities. More than 1,100 pharmaceutical distribution and retail operations have been privatized; nearly 600 independent primary care group practices have been created. Where universal entitlement to health care remains, USAID works toward

maximizing the use of resources within the public sector and stimulating market-based incentives through provider reimbursement and patient co-payment systems. Forty-four U.S.-E&E health partnerships strengthen the provision of health care services.

Progress has been made in developing capacity to fight infectious diseases. USAID, collaborating with other international agencies, has been a leader in promoting the implementation of the "directly observed therapy, short course (DOTS)" strategy to control the spread of tuberculosis, and prevent the development of multiple-drug resistant TB, in Russia and the Central Asian Republics (CARs). The CARs are reported to be polio-free as a result of USAID immunization programs. USAID assistance has also focussed upon viral hepatitis reference laboratories in Kazakhstan and, now, in Turkmenistan.

Frameworks for social insurance and social safety net programs have been established in some countries. Legal and regulatory frameworks for health insurance have been developed in eleven countries. Targeted, means-tested subsidies for housing (Kazakhstan and Russia), utilities (Georgia), and other forms of social assistance have been introduced as a way to mitigate financial burdens on national and municipal budgets while ensuring basic services to the most needy. USAID has also been instrumental in introducing pension reform, particularly private pension reform, in Hungary, Poland, Bulgaria and Kazakhstan and continues to be engaged in the early stages of reform in six other countries in the region.

Ways to address the needs of displaced workers and the unemployed are being demonstrated in a few countries. In the past decade, workers have been dislocated from their jobs due to economic contraction, privatization and enterprise restructuring, and the emergence of competitive markets in which low-skilled workers have difficulty contending for jobs. USAID, in partnership with the U.S. Department of Labor, has successfully demonstrated the effectiveness of public employment reform in anticipating and addressing many labor problems, both within the context of plant privatization and through more integrated approaches to sustainable economic development. In partnership with the private sector in Ukraine, USAID has effectively reformed the country's capacity to monitor trends and conditions accurately in the labor markets.

Environmental health threats at specific sites have been reduced. Accomplishments in the CEE northern tier include a 50 percent reduction in pesticide use at participating orchards in Poland, with no decrease in productivity or quality; and elimination of worker exposure to lead at battery plants in Hungary and Romania. Improved safety analysis and inspection capabilities increased operational safety at selected coal mines and nuclear power plants in Eurasia. In the CARs -- where the Aral Sea disaster has deprived millions from access to safe drinking water -- USAID's initiatives provided potable water to over 500,000 people, improved the health and sanitation practices of some 1.5 million persons, and promoted significant policy changes for more efficient water use.

Remaining Challenges in Social Transition

Although specific USAID interventions in the social sectors have produced positive results, they have not provided a broad-based approach to the social dimensions of transition. Public support for reform eroding because of the lack of basic social services, and unattended social problems are posing constraints to economic growth. Public financing for social services is severely constrained and, frequently, available resources are not well managed. At the end of 1998, only a handful of countries (the Czech Republic, Hungary, Poland, Slovakia, and Slovenia) had come close to reattaining their pre-transition (1989) income levels. Some of the most critical social issues facing E&E countries follow.

The burdens and risks of humanitarian crises continue. The E&E region has suffered a series of complex emergencies, caused or exacerbated by conflict, which have contributed to the serious delay or disruption of the reform process in affected countries. Most recently, Kosovo demonstrates the ongoing challenges facing the region in trying simultaneously to respond to humanitarian needs while promoting democratic and economic reform. The return of displaced people and refugees to their homes of origin is a critical dimension in attempts to reestablish stability and prevent future conflict. Early warning systems are needed to cushion the impacts of crises.

Health systems are in crisis and, in many countries, health status is deteriorating. Health systems are highly centralized, largely hospital-based, and inefficient.

Few resources are allocated to outpatient services and lower cost, preventive health care. Privatization of health services is incomplete. Inadequate and uneconomical public investments have resulted in declining health. Mortality rates for infants and children under the age of five are increasing in many E&E countries and life expectancy, particularly for males, has been declining for decades. Epidemics are underway or looming in tuberculosis, HIV/AIDS, hepatitis and socially transmitted diseases -- all diseases that affect the most economically productive age groups. Moreover, unhealthy lifestyles -- including tobacco and alcohol consumption -- contribute significantly to morbidity and mortality throughout the region.

Economic conditions and policy constraints contribute to unemployment, under-employment, and low productivity. Statutory and practical rigidities in the labor market (such as administrative restrictions on relocation, housing shortages, linkages between location and eligibility for social benefits, etc.) have prevented workers from seeking job opportunities where they exist. The post-communist deterioration of educational and health care systems inhibits the productivity of labor forces. Working conditions are another concern in the E&E region. Issues of worker rights, child labor and occupational health and safety exist in most countries of the region and are the subject of international labor standards of the EU and the International Labor Organization (ILO). Concern with displacing current employees contributes to governments' reluctance to privatize and restructure large strategic industries -- particularly in Eurasia. Consequently,

the private sector share of recorded employment is smaller in Eurasia than in CEE countries. The informal economy, however, is enormous.

Poverty and income inequality are pervasive. Rather than creating a large and stable middle class, transition realities are producing a growing underclass of chronically poor, presenting an additional burden to governments that are unable to balance their budgets. About 50 percent of Eurasia's population and 24 percent of Southeast Europe's are living in poverty. Those countries that have experienced the largest and most sustained drops in GDP and have been slowest to regain their 1989 income levels have also suffered the biggest increases in income inequality. The UNDP estimates that, for every decline of one percentage point in Russia's GDP, another 700,000 people enter poverty. In many countries, such as the Central Asian Republics, younger men are particularly vulnerable to limited economic opportunity and deepening poverty. This group represents a potential risk to social cohesion and stability.

Social insurance systems and social safety nets are inadequate and unsustainable. A hallmark of the communist era was the provision of universal subsidies for housing, utilities, health care and other social services, as well as income after retirement. Additional subsidies were targeted at privileged groups, such as military veterans, and disabled populations were generally cared for in public institutions. Not only did these state-run services and benefits consume large portions of government budgets, often their quality was mediocre to poor, and their

administration was highly inefficient. Over the past decade these systems have largely collapsed as a result of falling economic output, declining tax collections, and fiscal austerity requirements which have reduced government expenditures for social programs and created large arrears in pension and salary payments. Few countries to date have been able to replace universal benefits with targeted subsidies and alternative, market-based social insurance systems. Wholesale redesign of these systems is needed to increase efficiencies.

Specific population groups are vulnerable to violence, exploitation, discrimination, poverty and neglect. These risks have become painfully evident among *children* – particularly those living in institutions, thrust prematurely into the workforce, exposed to conflict, subjected to toxic or radioactive hazards, or identified early in life as mentally or physically handicapped. Other vulnerable groups include *ethnic and religious minorities*, especially those affected by conflict. In some countries, the majority of ethnic and national minorities are not part of the skilled and educated workforce assumed to be in place prior to 1992. Ethnic minorities must be given economic opportunities and be engaged in political dialogue if they are to be integrated into society. There is increasing evidence that *women-headed households* with children are suffering disproportionately because of discriminatory practices in layoffs and hiring. In retirement – which is usually mandated at an earlier age for women than for men – *female pensioners* receive smaller benefits but cope alone in their later years due to longer life expectancy.

Economic stress in general is leading to increasing instances of *domestic violence and exploitation of women* in international sexual trafficking.

Existing education systems are failing to reach a growing portion of the E&E population. Debilitated physical structures (and lack of winter heat in some places), staff shortages, increasing costs to parents, and increasing economic pressures requiring older children to seek work have contributed to declining school enrollments. Pedagogical approaches are highly traditional, neglecting basic skill development in problem solving, innovation, risk-taking, teamwork, and individual responsibility. Secondary vocational and technical training is not preparing students in areas relevant to the new marketplace, such as information technology, practical business skills, and foreign languages. Civic education is needed for people to understand their new rights and responsibilities as democratic institutions take root. Changing behavior is a long-term process, as demonstrated by the older generation, which remains entrenched in the ways of the old system.

III.

Strategic Directions

for 2000 and Beyond

“We seek a transatlantic partnership that is broad and open in scope, where the benefits and burdens are shared, where we seek a stable and peaceful future not only for ourselves, but for all the world.” President William Jefferson Clinton

A. Vision: Sustainable Partnerships

The E&E Bureau’s vision for 2000 and beyond is *to establish sustainable partnerships: between the United States and the countries of Europe and Eurasia, between these countries and other regions of the world, and among the countries themselves.* USAID sees these partnerships as mutually beneficial relations that will endure and leverage resources to continue the transition process, even in the absence of formal assistance programs. This vision directly supports U.S. foreign policy objectives and reflects the values of the American people and the aspirations of this Agency. The added dimension of sustainable, cross-national partnerships is instrumental in helping these countries overcome the economic and political isolation many of them now experience following decades of Communist rule. Realization of this vision will enhance prospects for stability, peace and prosperity in the region for many decades to come.

In E&E’s strategic assistance framework, partnerships are both an evolving way of doing business during the assistance period, **and** a vision for enduring relationships among countries, institutions, and peoples as assistance programs are phased down. USAID’s

role is to help countries develop the sustained capacity to enter into fruitful economic, political and social relationships with other countries, at all levels of society, long after bilateral assistance has ended. Integration into the world economy is one manifestation of this vision. Other manifestations include: participation in multilateral organizations such as NATO and the European Union; active bilateral commercial relations; cross-national networking and exchanges; and sub-regional agreements that address and resolve region-specific problems (e.g., the International Convention for Protection of the Danube River, an agreement involving Hungary, Romania and Slovakia to address trans-boundary water pollution issues).

Fostering mutually beneficial, cross-national ties implies that USAID should no longer operate solely on the basis of conventional donor-recipient relations. As appropriate, traditional assistance modalities, such as technical assistance and training, will be complemented by partnership mechanisms between people, communities and institutions in support of transition objectives (see Box 2, below). Such mechanisms will provide benefits to both parties and be based on an equitable sharing of talents, responsibilities, costs, risks and rewards.

Box 2: Health Partnerships Produce Results

Health partnerships supported by USAID promote extensive exchanges of health care professionals between partner institutions and leverage additional resources for health improvements in the region. As a result of these peer-to-peer interactions, E&E health care providers are adapting modern attitudes toward health care practices, solving problems in innovative and cost-effective ways, and practicing medicine based on scientific research.

More than 80 U.S.-E&E partnerships operating in 21 countries have improved the quality, delivery, and management of health care and created a cadre of health care professionals skilled in modern techniques and practices. Representing more than 25 states, U.S. physicians, nurses, administrators, and technical personnel donate their time, effort, needed supplies and equipment to E&E partners. Volunteer hours and other donations add up to nearly \$3 for every USAID dollar invested in the program. Beginning as a hospital-to-hospital program, health partnerships have expanded their focus and now encompass primary health care facilities, universities, and communities. Informal partnerships are also forming across borders in the region; for instance, a woman's wellness center in Moldova recently assisted a new center in Romania.

Examples:

- The *Kosice, Slovakia - Providence, Rhode Island* partnership improved neonatal care and promoted better coordination of services to ensure early identification of high-risk mothers and infants. Over a two-year period, the perinatal mortality rate in the area declined from 19.1 percent to 5.2 percent and the neonatal mortality rate fell from 24.2 percent to 7.2 percent.
- The *La Crosse, Wisconsin - Dubna, Russia* partnership created a model self-care diabetes outreach and education program, with support and contributions from a private U.S. drug company. Over 1,000 patients were trained to manage their diabetic conditions better, leading to cost savings of approximately \$60,000. This model is being replicated in five additional sites, with support from the Russian Ministry of Health.
- The *Atlanta, Georgia - Tbilisi, Georgia* partnership made nursing reform a priority. Accomplishments included: upgrading nurses training curriculum, establishing a national Nurses Association, creating the National Learning Information Center for health care providers and researchers, and starting the Georgian Medical Journal, the first post-Soviet medical research journal in the region. In coordination with the \$18 million World Bank loan to the Ministry of Health, the partners provide technical advice on national health policy.
- Through the *Turcianske Teplice, Slovakia - Cleveland, Ohio* partnership, a community-based health task force raised over \$40,000 to purchase a new ambulance for the town. Not only did this intervention provide reliable transport to the nearest hospital (30 miles away), it prompted the community to change their tax laws to encourage charitable contributions.

Because countries are at different stages of reform, the mix of modalities will vary, depending on country circumstances and needs. Over time, the relative emphasis will shift from a donor-recipient mode to a partnering mode. The mix of activities will seek a balance between the national government level and the institutional and local level. The E&E Bureau will draw on its experience to date with partnerships that have become sustainable (those that still exist three years after the end of direct assistance), as well as on other USAID experiences and analyses, to identify the salient characteristics of successful partnerships.

B. Lessons Learned: Program and Policy Implications

At this ten-year mark in USAID assistance to Europe and Eurasia, USAID has re-examined the transition experience and USAID's assistance role in the process. Notably, the Bureau has: reviewed progress and prospects for achieving program objectives across the entire region and developed graduation criteria for each strategic objective; assessed the continuing validity of the assumptions underlying USAID's assistance to E&E countries; analyzed the impact of the 1998 world financial crisis on the economies of these countries; and evaluated problems and opportunities in three significant areas -- small and medium enterprise development, civil society building, and social transition (see Bibliography in Annex B). This extensive "stocktaking" of USAID's assistance identified broad lessons that are influencing program design and resulting in modifications to E&E's strategic assistance framework

(detailed in Part IV). While it will take time for these lessons to be fully integrated into program activities, the Bureau is committed to incorporating them into country and regional programs.

Transition Timeframe: *E&E countries have not followed a common timeframe in their transitions to market democracy.* Transition requires profound changes in institutions, policies and behavior. Though relevant to the CEE Northern Tier countries that are at the point of graduation from bilateral assistance, this lesson has the strongest implications for the South Tier -- where ethnic issues have tended to dominate and countries are struggling with an overall economic environment and state of legislative reform that makes it difficult to progress -- and in Eurasia -- which faces an even broader range of reform challenges. The E&E Bureau recognizes the need to address longer-term constraints to transition, particularly in Southeast Europe and Eurasia. Programming must be selective, make effective use of scarce resources for transition assistance, and be consistent with broader U.S. foreign policy objectives.

Rule of Law: *Lack of respect for the rule of law is a fundamental constraint to successful transition.* Consequently, efforts to engender respect for the rule of law are central to the E&E Bureau's evolving approach. Rule of law is essential for democratic reforms to take root, for a thriving private sector, and for effective social programs. E&E programs will continue to emphasize the importance of policies, laws, regulations and procedures needed for market democracies. However, passing good

Box 3: Combating Corruption

The Europe and Eurasia Bureau addresses corruption as a serious, systemic impediment to sustainable economic, political, and social transition in the region. Anti-corruption assistance is integrated with other E&E assistance to:

- expand the capacity of governmental institutions to deliver services in a transparent and accountable manner (good governance);
- increase the "oversight" role of civil society, the media, and the business community through educational programs, advocacy, and public/private coalitions; and
- create more credible and predictable "rules of the game" for the legal and business communities.

These activities both strengthen the incentives for reform and reduce opportunities for corruption.

Combating Corruption in Georgia:

Anti-corruption activities are fully integrated into all of USAID's programs in Georgia. The Comprehensive Market Reform program addresses corruption by supporting the creation of laws and practices to promote transparency and consistency in the development of the private sector. Through the tax and fiscal reform activity, USAID is providing extensive assistance to create a central, automated information system to enhance the integrity and efficiency of tax collections. USAID is supporting the transparent implementation of enterprise (urban) land privatization legislation. Transparency is also integral to enterprise accounting reform and capital market development activities.

USAID's Rule of Law program supports institutional reforms to reduce corruption. An important activity supports the establishment of a competent, honest and independent judiciary. With USAID support, Georgia is the first post-Soviet country to institute a judicial requalification program. All sitting judges in Georgia have already been examined. Those who passed were rewarded with a several-fold increase in salary. The Georgian Procuracy (prosecutors) is now interested in institutional reforms, largely as a result of this judicial program. USAID supports training of lawyers, and drafting and implementation of a legal framework for fighting corruption. USAID assists NGO efforts to advocate for reforms, root out corruption and increase access to legal services. USAID programs in government decentralization, election support and, strengthening of the independent media also contribute to fighting corruption.

The Georgia Winter Heating Assistance Program uses transparent procedures and targets assistance to ensure that vulnerable populations are served and risks of corruption are reduced.

laws and regulations is not sufficient: changes are needed in individual attitudes and practices, and in the institutional capacity to put reforms into practice.

Individual Attitudes and Behavior: *The importance of individual attitudes, practices and behaviors for successful transition had been underestimated.* Cooperation among individuals is essential for new economic and democratic policies and institutions to thrive. Moreover, citizen participation is essential to shaping and deepening the policy reform process. Successful transition requires public confidence and acceptance of new ways of operating. E&E assistance will seek to build capacity to reach consensus by institutionalizing new patterns of people's participation in public affairs, public-private sector dialogue and partnerships, and public advocacy organizations. Changing behavior and building social capital is a long-term process. Across the portfolio, public education, training and exchange programs will foster a better understanding of the transition process and support the generational transition to democratic and market principles. Selective interventions for curriculum change in primary, secondary and technical schools will be explored.

Institutional Capacity Building: *The institutional capacity required for the fundamental operation of market democracies had also been underestimated.* Implementation and enforcement of new laws and policies are critically important. Assistance programs are now placing a much greater emphasis on interrelated legal and organizational reforms (e.g.,

improved management and technical capacity, strengthening legal systems and the judiciary, government transparency and accountability) at both national and local levels. This is reinforced by building civil society, including public advocacy institutions such as think tanks, non-governmental service providers, training organizations, "good government" associations, professional societies, consulting groups, and universities and private sector support organizations that help promote sustainability.

Political Will and Leadership: *Where political will and leadership for transition are lacking, two options must be considered.* First, assistance programs can help to create a national consensus for reform. To this end, E&E programs are reaching out to a broader constituency at the grassroots and regional levels to build an understanding of and demand for reform, and to develop a cadre of local leaders for change. Program strategies will continue to promote training and exchanges to nurture support and leadership for transition. Special attention will be given to women and the younger generation as future leaders in these societies. Second, assistance can be reprogrammed to other countries or other activities that have greater prospects for success. Both options are relevant to situations in which USAID is prohibited from providing direct assistance to host governments.

Combating Corruption: *The importance of reducing corruption cannot be overstated.* Corruption is pervasive and is proving to be a major constraint to in foreign investment and the development and growth of the private sector. Even in

some Northern Tier countries where transition progress is well advanced, there is concern that corruption and organized crime may erode reforms. USAID is designing mutually reinforcing programs in various sectors to address the fundamental systems needed to fight crime and corruption. This is reflected in activities to: improve government transparency and accountability; rationalize government regulation; enhance judicial independence and integrity; adopt international accounting standards; introduce cost-recovery techniques such as energy metering; develop media and NGO “watchdog” capabilities; improve corporate governance; and strengthen civil society organizations (see Box 3). Country programs – such as Bulgaria’s Coalition 2000 Program and Georgia’s rule of law activities -- adopt explicit strategies to combat corruption, and use the media to educate the public and officials alike on its corrosive effects. Allied with international organizations and other donors in Southeast Europe, USAID is giving increasing emphasis to combating corruption as an important focus area of the Stability Pact.

Social Transition: *Social progress has failed to meet the expectations engendered by the shift to market-economies; in a number of countries, social conditions have deteriorated.* Among those affected, a large, educated and politically important “middle class” – that includes doctors, scientists, engineers and others – has lost employment opportunities and endured declining living standards with the collapse of old institutions. Failure to reverse these trends tends to erode support for reforms and, ultimately, threaten economic and political stability

in transition countries. The social dimension of the transition will receive increased attention, including a new strategic objective to address the adverse impacts of transition. E&E’s new social transition strategy selectively addresses health and other social constraints to transition as well as acute humanitarian crises. Social sector activities will contribute to rationalizing the role and fiscal management of governments, increasing economic productivity, and fostering support for continued policy reforms. Activities will be implemented both as direct interventions on social issues, and as integrated approaches to associated economic or democracy and governance challenges.

Gender: *Bolstering the participation of women, as well as men, in the economic and political life of their countries will accelerate and deepen the reform process, another key cross-cutting issue.* Women have been very effective leaders and supporters of the economic and democratic transition, particularly in enterprise development and civil society. Promoting even greater participation will further accelerate reform. E&E will identify opportunities to encourage equal access, equal rights, equal protection, and a fair chance at the levers of economic and political power across the range of its programs.

Private Enterprise: *Increasingly, small and medium enterprises (SMEs) are being recognized as engines of growth.* SMEs are a significant source of income and employment growth. As a result, policy reform programs must take into account potential impacts on SMEs. Assistance interventions involve direct technical assistance to firms, increasing access to finance, and support for

business-oriented non-governmental organizations.

Reaching People through Local Initiatives: Community and regional development approaches are well suited to building cross-sectoral linkages and delivering the benefits of reform directly and tangibly to people. At the local level, E&E programs will promote the collaboration of actors in local government, NGOs, enterprise development, and service delivery and municipal utility restructuring. The critical importance of strengthening these interactions between public and private entities has led to the broadening of E&E's strategic framework to embrace the concept of "local governance." Through collaboration with progressive local leaders, demonstration activities, assistance to increase community participation, and public education, USAID acts as a catalyst for change. Regional initiatives in the Russia Far East and Samara, Kazakhstan (Atyrau) and Ukraine (Lviv and Kharkiv) will be tracked for possible application to other locations.

Conflict Prevention: The transition to democracy and market-based prosperity is hindered by civil war or separatist movements, ethnic violence, excessive crime, and anarchy – all of which have undermined the transition process in certain countries, if not prevented it altogether. Humanitarian assistance has been adapted to provide a bridge to more conventional programs, after short-term relief objectives have been met. E&E is finding ways to support the prevention of conflict in country strategies, and in some instances to identify and monitor indicators of vulnerability to crisis to assist in the development of an "early

warning system" on conflict. Grassroots programs aid in this process and can help alleviate problems before they reach crisis levels. Where ethnic tensions pose real constraints to transition progress, USAID seeks ways to integrate ethnic minorities into the mainstream of economic and political activity. Experience has shown that unless concerns about displaced persons and refugees are addressed, these groups remain vulnerable to manipulation and further crisis. On a broader scale, support for regional cooperation and integration of Southeast Europe into Euro-Atlantic structures is a comprehensive approach to promoting peace and stability in a war-torn area. Promoting regional collaboration around trans-boundary environmental problems, such as water issues in the Central Asian Republics, is another approach to preventing the outbreak of conflict.

Program Linkages: The remaining challenges in economic, political and social transition are tightly interwoven. For instance, economic restructuring helps to mobilize resources to improve economic and social status, which are necessary to garner political support for critical policy changes. In addition, interdisciplinary approaches are needed to tackle complex issues such as combating corruption, social transition, local development, gender equity, and conflict prevention. Formal and informal teams, combining talents from different technical disciplines will undertake joint analysis and action to address the range of complex issues inherent in the E&E transition program.

Region-wide Networking: Cross-border sharing can spare time and frustration as countries confront similar constraints

in their transition processes. Experience has demonstrated that USAID can play a key role in helping groups set-up region-wide networks for sharing success stories and the exchange of ideas on transition problems. The Partners in Transition conference in October 1999 signals USAID's commitment to supporting cross-border/intra-regional cooperation and networking for the next transition decade.

Other Donors and Agencies: *USAID has been successful both in coordinating with other USG agencies and donors, and in leveraging billions of dollars beyond its own resources for the region.* Given the size and duration of the transition task, USAID will expand its assistance approaches to include the concept of leveraging private sector resources through cross-national linkages and partnerships. The creation of mutually beneficial partnerships across nations is the long-term vision of the E&E program. Closer coordination with other USG agencies is important and will be sought to improve alignment of all U.S. funding in support of transition objectives.

C. Regional Differentiation of Programs

Strategies for achieving sustainable partnerships must be realistic about current obstacles to transition and tailored to reflect varying stages of reform progress in each country, taking into account such considerations as institutional development, political will, funding constraints, and management capacity. For that reason, different levels and types of USAID involvement are anticipated in each sub-region.

In the *CEE Northern Tier*, where countries are graduating from bilateral assistance, USAID is applying a post-presence approach to manage remaining activities, reinforce the sustainability of results achieved, and promote lasting institutional linkages between countries. Any new activity in these countries must address significant impediments to transition, identify tangible results to be achieved within a limited timeframe, and build capacity for sustainability after the end of USAID's involvement. In the very short-term, a variety of regional activities, managed by the E&E Bureau in Washington (e.g., regional energy cooperation, the Partners for Financial Stability which can provide short-term interventions in the financial area, regional workshops for independent journalists, etc.), may be available on a limited basis to help these countries to overcome some of the remaining obstacles to a smooth transition (dealing with the impact of the Russian financial crisis, to cite a recent example).

In addition, USAID is promoting a few "*legacy mechanisms*" for graduating countries to sustain partnerships primarily through private means. The Baltic-American Partnership Foundation, endowed to provide training and grants to enhance the capabilities of Baltic NGOs, began operations in late 1998. The Polish American Freedom Foundation, financed by reflows from the Polish-American Enterprise Fund, is dedicated to strengthening civic society in Poland by supporting economic reforms, training for social and economic leaders, and NGO development, and by assisting local governments in fostering local private enterprise development.

An important objective for these countries is rapid integration into the European Community. In addition, as these countries complete the transition journey, their involvement as partners with the countries of Southeast Europe and Eurasia will become increasingly important as leaders and potential donors of assistance. For example, the Polish-American-Ukrainian Cooperation Initiative (PAUCI) has been put in place to strengthen the emerging cooperative relationship between Ukraine and Poland and to enable Ukraine to take advantage of lessons learned from Poland's transition experience. PAUCI is providing Polish and Latvian expertise to improve the bank supervision capacity of the National Bank of Ukraine, promoting international cooperation to combat money laundering, and helping to improve the climate for Polish investment in Ukraine. In another case, the Polish Banker Training Institute (now sustainable but formerly funded by USAID) has provided training to Macedonian bankers in the use of a financial forecasting model.

In *Southeast Europe*, most countries must resolve ethnic and political conflict, build social capital, and reconstruct or establish national infrastructure and institutions that support market democracies. In many cases, these problems require *a regional approach* as suggested by the destabilizing influences of the recent financial crisis and the latest Balkans conflict over Kosovo. To this end, international efforts to address these problems and accelerate the integration of Southeast Europe into Euro-Atlantic structures have been mobilized under the *Stability Pact for Southeast Europe* and

the U.S. *Southeast Europe Initiative (SEI)*.

Within this regional framework for stabilization and association, USAID provides support *through well-focused, bilateral programs* that address internal constraints to economic reform and business development, participatory political systems, rule of law, and civil society development. By aligning economic, political and judicial norms with Western practice, the latitude for corruption will be reduced and the confidence level of would-be investors will be raised. In turn, increased foreign investment and trade will fuel economic growth, expand job opportunities, and advance prospects for integration of individual SEE countries into Western European and global structures. Assistance at the bilateral level is complemented by *regional programs* that promote cooperation, trade and partnerships among the countries in Southeast Europe – a key to long-term stability in the region.

Similarly, given the range of transition obstacles encountered in *the Eurasian countries*, the Bureau depends on *in-country staff to design programs that are responsive to country-specific problems and to build the institutional capacity required for market democracies*. Where appropriate, U.S.-Eurasian partnerships - -as well as partnerships among countries in the region-- are being introduced to further assistance objectives. Related programs in a number of countries, such as those operating through USG-funded Enterprise Funds and the Eurasia Foundation, have contributed to cross-national private relationships and cooperating mechanisms. These programs, for instance, are providing

opportunities to further regional stability objectives in the Caucasus.

In several countries, USAID has focussed resources on the development of public-private partnerships (between private business, local government, the NGO community, and as appropriate, foreign investors) to concentrate assistance and stimulate growth at the local and sub-national level. This approach seems particularly effective in countries where there is a lack of consensus at the national level to proceed with comprehensive policy change. USAID's program in Russia has been in the forefront in testing this type of Regional Initiative. By the end of 1998, the Novgorod pilot had facilitated over \$100 million in foreign investment and set-up lending mechanisms and training for micro-entrepreneurs and small businesses. Regional centers have been established in other Russian locations, in the Far East, Samara and Tomsk. Other countries presently concentrating assistance at the sub-national level include Kazakhstan (Atyrau) and Ukraine (Lviv and Kharkiv). Where there is reluctance to pursue a rigorous policy reform agenda, USAID is taking a grassroots approach to fostering small business development, NGO building, local government strengthening, and improvements in health and selected social service delivery. The underlying assumption in all these cases is that assistance at the grassroots and sub-national levels will, over the longer term, build an understanding of and demand for reform, as well as develop important linkages between segments of these societies and their counterparts in the West.

For *common concerns across Europe and Eurasia*, the Bureau will continue to design *less-management intensive, regional activities* which foster cross-border information sharing and nurture sector partnerships both during and after the completion of bilateral assistance programs. Examples are: the regional environmental partnerships, ECO-Links; the Local Government Information Network (LOGIN); and the Partners for Financial Stability program. Similarly, activities administered by USAID's Bureau for Global Programs, Field Support and Research -- such as the Global Technology Network for trade facilitation, and research partnerships -- contribute to sustainable partnerships involving Europe and Eurasia. These E&E and Global activities are able to respond quickly to unanticipated needs, focus on issues not fully resolved under the bilateral programs, and help keep all countries engaged in the development and growth of the region.

Sharing successful approaches and lessons learned across the region becomes increasingly important as experience with transition grows. To this end, the Bureau held the first "Partners in Transition: Lessons for the Next Decade" Conference in Warsaw in October 1999. Reform leaders from across the region met to exchange ideas, lessons learned and best practices about the transition process. This major forum built on earlier, sector-specific networking activities. It will facilitate future cross-national dialogue through follow-on focus groups, Internet contacts, and workshops built around common concerns such as corruption, women as transition leaders, safeguarding independent media, and/or sub-regional peace and stability themes.

A second region-wide “Partners in Transition” conference is planned for Fall 2001.

IV.

Europe and Eurasia: Strategic Framework for 2000 and Beyond

The E&E Bureau's Strategic Framework consists of a vision, three strategic assistance areas and goals, and twelve strategic objectives (SOs) selected for their importance to the transition of E&E countries to market-oriented, democratic societies. This framework serves several important purposes. It:

- communicates the Bureau's strategic focus to development partners, to other groups outside of USAID, and to the American public;
- makes explicit the Bureau's strategic priorities;
- establishes parameters for formulating country strategic plans and regional activities;
- encourages focus and concentration on core results essential to successful transition;
- provides a common point of reference for E&E management-by-objectives in conformance with USAID policy and goals, and the Government Performance and Results Act of 1993; and,
- facilitates cross-country comparison of results, and experience sharing on similar development initiatives, and well-structured, reporting performance in the region.

Vision for the E&E Region:

To establish sustainable partnerships between the United States and the countries of Europe and Eurasia, between these countries and other regions of the world, and among the countries themselves.

USAID programs in economic restructuring, democratic transition, and social transition contribute to a process through which E&E countries build the capacity to participate in enduring and mutually beneficial partnerships with other countries. USAID's role is to help countries develop the sustained capacity to enter into fruitful economic, political and social relationships with other countries, at all levels of society, long after bilateral assistance has ended.

Strategic Assistance Area I: Economic Restructuring

Goal: Foster the emergence of a competitive, market-oriented economy in which the majority of economic resources is privately owned and managed.

During the next decade, USAID will assist E&E countries to build on existing capacity to manage their own market-oriented economies, facilitate private enterprise development, increase employment opportunities, and reduce poverty. Economic restructuring is the process of improving laws, institutions and the capacity of people to produce, to trade, and to invest in the future. This requires changing attitudes and behavior, establishing macroeconomic stability, adopting economic and environmental policies and institutions appropriate to market systems, developing technical and managerial knowledge and skills, and forging new partnerships within and among countries. In the face of these enormous challenges, USAID

collaborates with the International Monetary Fund, multilateral development banks, other donors and partners, and other US Government agencies to assist E&E countries both to establish the foundations for economic growth and to ensure that the benefits of this growth reach a growing population. Economic restructuring and growth activities are fully consistent with U.S. foreign policy objectives to increase regional economic and political stability and expand commercial opportunities.

E&E Bureau programs operate at all levels of society to broaden the base of economic activity. This includes activities with regional as well as national institutions, with provincial and municipal authorities, with business and professional associations, and with grassroots NGOs and micro, small and medium enterprises. Through program linkages to the democracy and social sectors, economic restructuring activities will set the stage for expanding the benefits of transition to a greater proportion of the population through rising labor productivity, increased employment, reduced poverty, gender equity, and rising living standards. Efforts to extend the rule of law in the economic sphere, to contain corruption, and to integrate gender considerations will cut across this Strategic Assistance Area. Fiscal decentralization and local development will complement actions at the national level.

Over the next three to five years:

- Northern Tier countries – where economic restructuring is well advanced and USAID’s bilateral programs have graduated – may be expected to deepen partnerships and

increase trade and investment with the U.S. and the world, and, generally, to sustain economic growth.

- Southeast Europe will restore economic growth and strengthen its capacity to compete in world markets; of these countries, Albania faces the greater challenges in institutional and human capacity development.
- In Eurasia, USAID will provide targeted assistance for policy change where opportunities exist, while continuing to strengthen capacity, especially among private enterprises and business and professional associations. Progress will be made in local development, developing advocates for economic transformation, and preparing a new generation of market-oriented entrepreneurs and leaders.

SO 1.1: Increased transfer of state-owned assets to the private sector.

Private ownership of productive assets is critical to the formation of competitive markets, the achievement of economic growth through private initiative, and the efficient mobilization of productive resources. Privatization of state-owned assets is key in redefining the role of government from one of command and control to a facilitator of economic activity and a provider of essential services. While mass privatization is far advanced in many countries, the privatization agenda is not complete. A major challenge in much of the region is partial reform, where free-market competition is impeded by remaining state-owned enterprises, where fair competition and anti-monopoly policies are absent, or where the transfer of

management control has not followed the transfer of enterprises to private ownership.

Where appropriate, the E&E Bureau will continue to support privatization of enterprises and farms. Increasingly, Bureau programs will emphasize improving corporate governance and privatizing agricultural, urban and enterprise land, municipal services, and strategically important enterprises such as financial institutions, power and telecommunications utilities. Privatization activities will stress the importance of attracting foreign investment as a means of mobilizing capital, increasing competition and accelerating knowledge transfer. As a general rule, privatization through tenders rather than through voucher programs holds the most promise at this stage of transition.

Privatization has significant linkages to other E&E programs. To be successful, privatization programs require a supportive legal and regulatory environment -- including bankruptcy law, and effective financial and asset markets -- and consideration of potential unemployment or disruptions in social services here-to-fore provided through the workplace. Privatization directly supports associated objectives in private enterprise growth, capital markets, energy restructuring and local development. When implemented within the context of "good governance", privatization expands participation in economic decision-making, helps to broaden the benefits of economic reform, and promotes new investment.

Elements of USAID assistance include:

- Continuing support for privatization of small enterprises, as well as large enterprises and farms, including privatization of strategically important enterprises.
- Liquidating firms that cannot be privatized.
- Land privatization.
- Privatization of municipal services.
- Improving corporate governance.
- Assisting governments to adjust to their new roles as minority stockholders in firms that are not fully privatized.

SO 1.2: Increased soundness of fiscal policies and financial management practices

Sound fiscal policies and practices are critical to sustainable economic, political and social transition. Fiscal reform is integrally linked to the full range of E&E programs: successful fiscal reform both facilitates and depends upon growth of private enterprise and the development of financial markets; transparent and efficient fiscal management systems are essential to strengthening the rule of law, enhancing public accountability, and reducing opportunities for corruption; fiscal decentralization is a key component in efforts to strengthen local governance; and pension reform and sustainable financing of social services are critical components of social transition. The importance of these linkages suggests that E&E country strategies should incorporate cross-sectoral perspectives more fully than in the past.

Governments' willingness to use this type of assistance is critical to its success and USAID's experience in this area has

been mixed. For the Northern Tier CEE countries, fiscal sustainability thresholds have been reached or are within reach. In these countries, E&E plans to maintain a “post-presence” capacity to provide rapid but limited access to technical expertise to respond to unanticipated fiscal crises or specialized needs. In Southeast Europe and Eurasia, the E&E Bureau will engage selectively, where opportunities exist. In these countries, future programs will place greater emphasis on developing the human resource and institutional capacity required for fiscal sustainability. Fiscal decentralization and balancing fiscal with social transition objectives will also be prominent in future programming.

USAID supports five principal areas of fiscal reform:

- Tax policy: the modernization of tax codes and systems to emphasize transparency, simplicity and equity.
- Tax administration: organization by function, taxpayer registration, taxpayer services and education, audits, collections and enforcement.
- Budget formulation and execution: laws on budget and treasury operations, macroeconomic and revenue forecasting, budget formulation, performance-based budgeting using cost-benefit analysis, expenditure accounting and controls, and debt management.
- Inter-governmental fiscal relations: sharing of revenue and spending authorities between national and sub-national levels of government.
- Pension reform: revenue and expenditure issues related to both existing “Pay-As-You-Go” and new, private pension systems.

SO 1.3: Accelerated development and growth of private enterprises

As countries move from issues of economic stabilization and restructuring to concerns with growth, **and**, as they grapple with the intense need to create employment, reduce poverty, and improve the standard of living for average citizens, activities under this objective take on increasing importance.

Getting policies right and respect for the rule of law will remain paramount. Sound and effective economic policies are necessary for increased trade competitiveness, attracting investment, and achieving sustained economic growth. USAID assists national governments, provincial and local authorities, and private and NGO advocates to adopt and implement policy reforms.

Robust micro, small and medium enterprises -- including agricultural producers and agribusinesses -- are essential to economic expansion and job creation. In addition, privately owned enterprises are a key element of civil society. E&E programs will help to strengthen and work through business and professional associations and private sector service providers in recognition of the fact that business services will only be sustainable if a local capacity is developed. E&E programs support the development of women-owned businesses, a major, but often unrecognized contributor to SME growth; women own one-third of new enterprises in the region.

These private enterprise activities have important synergies with other programs. Growing private enterprises --

especially micro, small and medium enterprises -- are vital to helping establish new democratic principles and institutions in the region and in furthering transition objectives at the local level. Private enterprises provide jobs and income for an emerging middle class that will help to sustain reforms necessary to bring the former communist countries into the global marketplace of free nations. Private sector growth is critical to generating revenues for public expenditures and social transfers.

The E&E Bureau's Partnerships for Sustainable Enterprise Growth strategy highlights six elements of USAID assistance:

- Legal and regulatory reform: Governments must recognize the rights of citizens to own and engage in property transactions, and they must establish legal and rule of law frameworks that allows economic incentives for economic growth, competition, and reduced transaction costs. The process of defining and implementing these policy changes is as important as the policy outcomes themselves. USAID's experience has demonstrated that participation of stakeholders – those affected by policy decisions – leads to better policy choices and better implementation of those choices.
- Technical assistance to enterprises helps business owners develop the skills and knowledge necessary to manage their operations and market their products better.
- Trade and professional associations are vital to lobbying governments on improving the enabling environment for private enterprise, and they provide valuable services to their members.

- Increased accessibility to financial services – including banks, micro-lending and venture capital funds -- enables enterprises to implement their business plans.
- Educating the new generation of entrepreneurs and policy makers for private enterprise development requires training in principles of modern business management and market economics, and, for public officials, training on the role and needs of market economies and the required economic reforms.
- The sixth element, privatization, is addressed by SO 1.1, above.

SO 1.4: A more competitive and market responsive private financial sector

This objective contributes to the development of banking and capital markets, and seeks to improve private sector access to a wide array of financial instruments at competitive, market-determined rates. USAID emphasizes strengthening the safety, stability and transparency of financial systems. This objective is critical to decentralizing control of financial resources and assuring that the allocation of capital to its most productive uses. It is key to the economic restructuring process, and contributes to increases in productivity, sustainable growth and higher standards of living.

The impact of the world financial crisis on E&E countries demonstrates the potential susceptibility of these new systems to external shocks, particularly where macroeconomic structures are not fully in place. For that reason, USAID is developing new programs, such as Partners for Financial Sustainability, that will promote cross-national cooperation

and information sharing, to help even the more advanced countries consolidate and deepen reforms in this sector. Financial reform programs have strong linkages to private enterprise, pension reform, privatization, energy sector restructuring, and local development activities. These linkages will be exploited and strengthened.

Overall, USAID supports activities to reform and rebuild financial institutions, by privatizing state-owned banks, restructuring them, cleaning up the enormous bad debt that overhangs the economies, allowing entry of new and foreign banks, creating a level playing field for the entire financial system, and changing the role of the state from owner and controller to that of a strong and effective regulator. Elements include:

- Establishing a market-oriented legal and regulatory framework for banking.
- Developing effective, independent, professional bank regulatory authorities.
- Strengthening banking infrastructure, through self-sustaining bank training institutes, conversion to International Accounting Standards, building electronic payments capabilities, creating independent credit rating agencies, and establishing deposit insurance schemes.
- Establishing private sector housing finance mechanisms.
- Drafting laws on securities commissions, securities, and investment companies.
- Establishing sound capital market institutions -- independent securities regulators and share registries; trading mechanisms; clearance and settlement operations; depositories.

- Promoting fair and transparent operations, through consolidation of shareholder records, improved corporate governance and shareholder rights, and adoption of International Accounting Standards.
- Creating trade associations and self-regulatory organizations.
- Public education.
- Developing markets for government securities, commodities and municipal bonds.

SO 1.5: A more economically sound and environmentally sustainable energy system

Energy systems are important to U.S. foreign policy objectives in the E&E region, and to economic restructuring and growth. Foreign policy concerns include security of the world energy supply, economic and political independence through open energy markets, safety of nuclear power plants, and reduction in greenhouse gas emissions. Inefficient and burdensome energy systems are behind many of the transition problems in E&E countries, including fiscal and balance of payments deficits, unreliable power supplies, environmental waste, and vulnerability of the poor to inadequate heating.

Given progress to date in energy restructuring -- and assuming regulatory achievements can be sustained -- development of functioning electricity markets and strategic privatization of electric companies now emerge as significant challenges. Nuclear safety concerns remain in key countries, with solutions dependent on major advances in power sector reforms. Many energy issues are cross-border in nature (e.g., power grids, Caspian energy

development, emissions trading), requiring increasing attention to regional cooperation and transnational networking activities.

Experience gained in the implementation of energy restructuring programs highlights this sector's linkages to other E&E objectives. For example, energy efficiency activities have the potential to help create savings for the public sector, freeing financial resources to meet social needs at the local level. In addition, experience gained through participatory decision-making regarding electricity and heating services contributes to the development of local governance.

USAID energy programs support the following elements:

- Adoption of rational energy prices and sound national energy policies.
- Improved energy efficiency and reduced emissions in industry, buildings and power and heating systems.
- Restructured, commercialized and privatized energy subsectors (power, oil, gas, coal).
- Increased safety of Russian-designed nuclear reactors.
- Expanded regional and international energy trade and integration of energy systems with Western Europe and international energy markets.

SO 1.6: Increased environmental management capacity to support sustainable economic growth

Environmental sustainability is a foreign policy objective, embodied in legislation and in the Agency's Strategic Framework. Given the magnitude of environmental problems across the E&E region, comprehensive remediation is far

beyond the scope of USAID's potential interventions. This objective provides the necessary enabling environment for making improvements in environmental management methods and systems. It underscores the importance of the environment, with its natural resource base, as a valuable economic resource. Activities in sustainable forest and water resource management, industrial growth, and management of biodiversity and land have proven to be economically beneficial for many countries. Activities under this objective contribute to the U.S. Government's Global Climate Change Initiative.

In country programs, environmental issues are often integrated into other strategic objectives, rather than being treated as stand-alone initiatives. This is demonstrated by the widespread growth of environmental NGOs under USAID-supported citizen participation programs. With USAID's increased emphasis on social transition issues, environmental health concerns are being addressed more systematically under the bureau's refocused health objective (see SO 3.2 under social transition). In the more progressive countries, resources permitting, U.S.-E&E environmental partnerships are envisioned. Over time, these partnerships should open markets to U.S. environmental businesses while also addressing issues of environmental abuse.

USAID supports the following elements:

- Strengthened policy, legal and regulatory framework.
- Increased environmental trade, finance and investment.
- Best practices adopted by industrial and public sectors.

- Improved management of natural resources and biodiversity.
- Increased institutional ability to identify and remedy (mitigate) environmental problems.
- Increased participation of NGOs and citizens in environmental decision-making.
- Regional collaboration promoted in selected transboundary corridors and areas to help prevent conflict.

Strategic Assistance Area II: Democratic Transition

Goal: to foster democratic societies and institutions through empowerment of citizens, independent media, rule of law, and good governance (revised).

USAID is committed to addressing the long-term challenge of promoting the fundamental values of democratic governance and citizen participation, and the development of democratic institutions. Special emphasis will be placed on working across sectors to establish the rule of law, fight corruption, and increase the involvement of local governments and communities in providing leadership and mobilizing resources for transition. Strengthening the independence and integrity of judicial systems will take on increasing importance as countries tackle crime and corruption issues, and work toward improving their business environments. Supporting the continuing development and viability of election processes, independent media, and the NGO sector will be fundamental to involving and deepening individual participation in transition.

Democracy assistance will be closely aligned with economic restructuring and

social transition activities to foster the evolving role of local and national governments in market democracies. Civil society organizations help to identify economic needs, define and pursue policy reforms, and mobilize self-help efforts. Reliable, even-handed rule of law is key to economic growth. Competent municipal governments can spur local economic development and contribute to an improved quality of life for citizens through efficient provision of municipal services and infrastructure management.

SO 2.1: Increased, better-informed citizens' participation in political and economic decision-making

This strategic objective fosters the building of a vibrant civil society, in which citizens help to identify economic needs, freely debate political, economic and social issues, and mobilize self-help efforts. USAID will help to empower citizens to understand their roles and responsibilities in a participatory democracy, make informed choices, and take initiative. Among donors, USAID has a recognized comparative advantage in supporting key aspects of citizen participation: strengthening non-governmental organizations, assisting the creation and survival of independent media, and fostering the development of representative political parties and the holding of free and fair elections.

Progress to date suggests that institutionalizing a strong civil society is a long-term endeavor, particularly in the Balkans and many Eurasian countries where there are serious issues of nation-building and economic instability. As feasible, assistance will be provided at both the grassroots and national levels.

Activities and outcomes under this objective are directly linked to all other aspects of the E&E strategic framework. Experience has proven that citizen involvement in policy dialogue leads to better policy choices and better implementation of those choices. The Bureau's success in local development is in part due to the work of NGOs in advancing reform agendas at the local level. The next great challenge is to help local NGOs become self-financing and sustainable.

Resource allocation decisions will be based on a number of factors, including advances or backsliding in country progress indicators, openings in the policy environment for change, and geopolitical considerations. For instance, USAID will not provide support for elections in counties that are not taking steps to make their processes free, fair and transparent. USAID will consider providing targeted, ad hoc support in response to opportunities in post presence situations, where there are no active bilateral assistance programs.

Key elements supported by USAID assistance include:

Political Process

- Supporting free and fair elections.
- Fostering the development of political parties to articulate and represent citizens' interests.

Sustainable, Indigenous NGO

Development

- Establishing an enabling policy and legal environment for growth of effective civil society organizations (CSOs).
- Improving CSO capabilities in internal governance, management, fund-raising, policy advocacy, and

providing needed services to communities and constituencies.

- Improving public awareness and understanding of the roles, rights and responsibilities of individual citizens and of CSOs.
- Development of indigenous organizations capable of sustained support to CSOs.
- Strengthening independent, representative labor unions.

Independent Media

- Establishing a legal and regulatory environment that promotes free, independent media operations.
- Improving professional journalism and business management.
- Increasing the effectiveness of media associations.

SO 2.2: Legal systems that better support democratic processes and market reforms

This objective is the locus of legal and judicial reform activities supporting E&E efforts to establish the rule of law, including activities to protect civil, political and property rights, and to place limits on the arbitrary actions of government. An independent judiciary is an essential element for transition to a fully functioning market democracy. Judicial systems must have the capacity to enforce the strong legal and regulatory framework required by many of the other strategic objectives in the E&E framework. Administrative code reform, enforcement of court decisions, and, in a broader sense, good public and corporate governance are necessary to support the legal reform process, fight corruption, and foster democratic processes, social equity and economic growth.

E&E programs have recognized the direct links between legal system reform and successful economic, democratic and social transition. Several USAID missions have actively integrated rule of law and legal reform issues through activities that combine the institutional reform issues under SO 2.2 with the substantive policy, legal and regulatory issues addressed under SO 1.3. This model may have application for other transition objectives, such as legal and environmental reform, where the latter necessitates a strong regulatory framework for effective implementation.

Rule of law programs are central to E&E Bureau anti-corruption efforts. This objective contributes by helping to define and enforce regulatory boundaries between public and private sector activities and to establish rules governing conflict of interest cases. Democracy programs in general will seek additional ways to incorporate corruption concerns into ongoing activities, such as investigative media programs aimed at increasing government accountability and the development of NGO monitoring of public sector transparency and accountability. Stronger linkages also will be sought between NGO development and judicial systems strengthening to encourage broader public awareness of individual legal rights and responsibilities.

USAID supports the following elements under this strategic objective:

- Establishing and implementing constitutions, codes and laws that
- embody democratic norms and procedures.
- Upgrading the capabilities of the judiciary, prosecutors' offices, the

legal profession, and bar associations.

- Strengthening judicial understanding of market economy principles -- including transaction forms, finance and accounting -- and adjudication of commercial law.
- Modernizing court administration to support more independent, transparent and efficient judicial procedure.
- Improving criminal statutes and law enforcement.
- Establishing processes and organizations that reduce government corruption and human rights violations.
- Supporting enforcement of court decisions through institution building.
- Increasing business and general public awareness of reforms and legal rights.
- Strengthening the institutional capacity of legislatures.

SO 2.3: More effective, responsive and accountable local governance (formerly government).

Increasingly, local governments are viewed as a catalyst for change. Municipal governments have the lead responsibility for performing many of the tasks essential to economic reform and play a key role in the provision of social safety nets. Effectiveness, responsiveness and accountability in the performance of many critical public sector functions are best achieved by assigning responsibility to levels of government closest to the people and by transforming relationships between local and central governments. Because the interaction of local government with citizens, civil society organizations, and

the business community is essential to sound performance by local governments, the scope of this objective has been broadened to incorporate the concept of “governance ” – taking into account citizen participation in government initiatives.

Local governance activities will promote practical means for mobilizing local resources, addressing social welfare issues, stimulating local economic development, restructuring of municipal utilities and improved service delivery, establishing fiscal federalism, and promoting political consensus for reform. The strategy depends on creating successful partnerships between government, citizen groups, and the private sector at the local, regional and national levels. The cross-sectoral and multi-level approaches necessary to achieve results will depend on and support efforts under other strategic objectives, including local employment generation and business development (SO 1.3), municipal utilities and service delivery (SOs 1.5, 3.2 and 3.3), and fiscal federalism (SO 1.2). In many instances, transition obstacles faced at the local level will shape national level policy dialogue and programs.

USAID supports the following elements:

- Improving citizens’ participation through civic education, NGO leadership, public hearings, citizens’ advisory boards, and private-public partnerships.
- Establishing laws and regulations to enhance local governments’ administrative and financial authority (including fiscal decentralization), and to rationalize intergovernmental roles and responsibilities.

- Improving local government revenue generation and revenue sharing arrangements with central government.
- Strengthening local government technical, financial, and managerial capabilities and delivery of urban services.
- Making greater use of competitive procurement procedures and private contracting for urban service and management and maintenance of municipal housing.
- Developing municipal and professional associations.
- Strengthening trans-border activities and linkages

Based on past experience, the relative mix of activities under this objective as well as linkages with other strategic objectives will be varied to address different circumstances. Where national governments have empowered local authorities to act progressively, local initiatives will play a dynamic role in the country’s transition process, helping to consolidate and deepen reforms. Where national governments are less willing to share in power and resources, local governance programs will foster a demand for reform from the grassroots. In nations torn by civil violence, programs under this objective will promote the rehabilitation of critical infrastructure and democratic processes. In countries struggling with the adverse social impacts of transition, this objective will promote local economic development, support grassroots political reform, and help provide a targeted social safety net to those in need. The transfer of knowledge and practices among countries will continue to be supported through regional networking

and the development of a local government information network.

Strategic Assistance Area III: Social Transition

Goal: Enhance the ability of all persons to enjoy a better quality of life within market economies and democratic societies.

During the next transition decade, USAID will increase its emphasis on the critical social issues arising from the transition process and from the legacy of economic, social and political systems that existed before the start of the transition to market democracies. Whereas building robust market economies remains the best long-term strategy for improving living standards, disturbing social trends indicate that this approach, by itself, is not sufficient to achieve broad-based prosperity and a good quality of life in the medium term. Moreover, improved education, health and social protection are needed to sustain economic restructuring and growth, and democratic transition. In addition, U.S. foreign policy objectives are served by the contributions of social transition programs to maintaining regional stability and reducing global health risks.

In common with the other strategic assistance areas, social transition requires change at many levels, including: establishing public and private consensus on the broad goals and values to be pursued in social policy, as well as on roles and responsibilities of key actors (e.g., public vs. private sectors, national vs. local levels); promulgating new or restructured legal authorities and policy frameworks

governing social welfare functions and financing; identifying financial resources to manage and sustain sound social programs; adopting new paradigms for social program administration and burden-sharing among public and private providers of services; fostering individual initiative and group self-help; and strengthened public and private institutions and human capacity in relevant social areas.

While putting these systems in place is well beyond the scope of USAID resources, the Agency will play a catalytic role in coordination with other donors and partners. Experience in other sectors has demonstrated the powerful potential of USAID's work in policy reform, capacity development, and experimentation with innovative pilot projects to leverage and mobilize large-scale investments by international finance institutions, other donors, private strategic investors, and the countries themselves.

Within this context, the E&E Bureau is revising and strengthening Strategic Assistance Area III by introducing a new goal statement for social transition, initiating a new strategic objective (SO 3.4) focused on the mitigation of transition-related social impacts, and refining SOs 3.1 (on improved humanitarian response) and 3.2 (on health). Forming linkages between this strategic area and economic restructuring and democracy building is essential to achieving social transition objectives. While the revised SO structure provides opportunities to undertake targeted activities aimed specifically at social transition objectives, the Bureau equally encourages incorporation of social impact measures into economic and

democratic programs under all strategic objectives.

SO 3.1: Strengthened humanitarian response to crises. (Formerly, “*Improved response to and management of humanitarian crises.*”)

Recognizing the frequency of conflicts and crises in the E&E region, there continues to be a need for humanitarian assistance. When complex emergencies break out, USAID’s approach is: first, to help to stabilize the situation as quickly as possible; and second, to shift into programs that promote resettlement, self-sufficiency and the restart of economic productivity of vulnerable populations, while discouraging dependency or a sense of entitlement on the part of beneficiaries.

Humanitarian activities are often the most visible and tangible parts of USAID’s work, both in assisted countries and in the United States. In many cases, these activities put a “human face” on U.S. government assistance. Future E&E programs will strategically link humanitarian activities to other parts of a country’s assistance plan so as to leverage and enhance actions needed for progress in other strategic objectives. By its nature, humanitarian assistance is linked to longer-term efforts in private enterprise, energy efficiency, citizens’ participation, local governance, health, and mitigation of adverse social impacts.

The following assistance elements reflect the *relief to development continuum* explicit in this objective:

- Establishing early warning systems to identify and monitor vulnerabilities

- Meeting urgent humanitarian needs during crisis.
- Maximizing impact of humanitarian donations from all sources through better management.
- Initiating and promoting post-crisis transition programs (e.g., assistance to returning refugees and displaced persons, self-help initiatives, restoration of infrastructure/services, conflict resolution, and post-conflict counseling.
- Strengthening the local capacity to meet humanitarian crises.

Accomplishing this strategic objective requires close coordination among E&E missions, E&E/W, and the Bureau for Humanitarian Response (BHR). Field missions provide the country-specific knowledge necessary to implement assistance quickly and effectively. E&E/W brings the regional perspective, the lessons learned elsewhere in the region, the resources available to respond, and the coordination of the response. BHR brings the emergency response capacity, with its ability to tap quickly critical skills in the private sector at the moment an emergency arises. Generally, one of two conditions needs to prevail before Missions phase out of this strategic objective: (1) the economy recovers from crisis and the civic infrastructure begins to service populations affected by the emergency; or (2) there is a political settlement to the crisis, thereby allowing the return or integration of the population displaced by the conflict.

SO 3.2: Increased promotion of good health and access to quality health care.

(Formerly, “*Improved sustainability of health and other social benefits and services.*”)

Previously, many U.S.-funded health activities were implemented as special initiatives, rather than as an explicit part of the transition program supported by the USAID mission. This revised strategic objective recognizes the critical role that healthy populations play in the overall transition process, and the integral role that health activities can play in USAID transition programs. This objective incorporates basic health issues, such as prevention, access (financial and geographic), equity, quality, efficiency, privatization and sustainability. Where critical infectious diseases can reasonably be addressed through a strengthened and integrated primary health care approach, they will be. Where an effective integrated approach is not deemed feasible, vertical disease-specific interventions may be needed to continue for the immediate future (e.g. tuberculosis, HIV/AIDS, hepatitis, and disease surveillance). This objective emphasizes the vital roles of individuals, families and communities, as well as national and regional governments. It also explicitly reintegrates environmental and occupational health into the health program.

The five principal areas of this health objective are:

- Legal framework: enactment of laws, regulations and policies that promote community-based primary health care.
- Resource utilization: improve the mobilization, allocation and use of

health care resources (human, financial, and information).

- Quality of health care: strengthen primary and clinical health care; promote evidence-based protocols, client-centered services, quality assurance programs, and national accreditation of health providers.
- Citizens’ participation: promote public information about healthy lifestyles, and personal health care rights and obligations, including citizen advocacy.
- Environmental health: reduce health risks associated with air, water, sanitation and occupational safety issues.

A wide variety of approaches will be included to implement activities under this objective, including technical assistance and training, development of tools and guidelines, analysis and operations research. Building on successful past practices, U.S.-E&E health partnerships will be fully integrated into program approaches under this objective.

SO 3.4¹: Mitigation of adverse social impacts of the transition to market-based democracies.

This new strategic objective seeks to increase E&E’s focus on social transition issues and enhance USAID’s ability to undertake social reform activities within a coherent framework and in relationship to other transition objectives. USAID missions are encouraged to integrate social issues into ongoing programs.

¹ The designation, SO 3.3, is reserved for certain environmental health activities initiated prior to Fiscal Year 1999, to facilitate accounting and reporting.

Elements under this objective address critical unmet social needs:

- *Poverty*: develop the legal framework for anti-poverty programs and design social safety net systems such as targeting of subsidies, NGO services to the poor, temporary employment programs, etc.
- *Social insurance reform*: develop options for the design, financing and administration of pension and insurance (health, unemployment and disability) systems.
- *Employment*: promote policies and programs which advance workers' rights and international labor standards, remove labor market rigidities and assist workers in moving into jobs created by market economies.
- *Vulnerable groups*: increase protection of groups vulnerable to exploitation, violence, discrimination and neglect.
- *Education reform*: test models for new curricula and learning environments appropriate for democratic systems and market economies; help countries to maintain universal education and high educational attainment levels; and, develop and test training programs for social-sector specializations.

A new Program Objective Team is being established for this objective to provide guidance and assistance to field missions in systematic results tracking in the social transition area, and cross-border dissemination and sharing of lessons learned.

V. **Program Implementation and Performance Measurement**

A. Program Implementation

The majority of USAID activities in the E&E region are administered by field missions under their approved Country Strategic Plans. Country strategy preparation and review procedures are described in Agency policies and in the E&E Bureau's *Guidelines for Strategic Plans*. Missions are expected to select and adapt components of the E&E Bureau Strategic Framework to address country needs. It is primarily at the country level that program priorities are set, taking into account resource limitations and management capacity. In accord with USAID policy, Country Strategic Plans are backed up by analyses that explain and justify strategic priorities. As appropriate, these analyses address: host country and partners' perspectives on assistance priorities; the countries' economic, environmental, political and social constraints and opportunities (with attention to conflict prevention, gender and anti-corruption considerations); the relevance of different transition hypotheses to country conditions; host country capabilities; US foreign policy considerations; the programs of other donors and partners; and USAID's experience and comparative advantage. Box 4 describes implementation mechanisms.

The E&E Bureau also manages a number of regional support activities to:

- help establish partnerships and legacy institutions;
- support participant training and exchange activities for all E&E countries;
- foster sharing of information, including lessons learned, on a sectoral basis; and

- address cross-border issues.

The E&E Bureau collaborates with the Bureau for Humanitarian Response (BHR) on programs involving humanitarian assistance, food aid, conflict prevention, and on certain US PVO activities such as the Farmer-to-Farmer Program. In FY 98 and 99, BHR's Office of Foreign Disaster Assistance and Office of Food for Peace administered humanitarian assistance and/or PL 480, Title II Food Aid programs in 15 E&E countries. In the area of crisis prevention, BHR's Office of Transition Initiatives is advising the Caucasus Mission, where Georgia is one of the Agency's pilot prevention countries, and manages assistance in Bosnia, Croatia, Kosovo, Montenegro and Serbia. BHR PVO strengthening programs operate in 15 countries.

The Global Bureau (G) provides extensive technical support to specific programs, notably: agriculture and agribusiness in Russia and Ukraine; democracy and governance in Bosnia, Bulgaria, Poland, Russia and Ukraine; health and population in Romania, Russia and Ukraine; and, gender programs in Bulgaria, Croatia, Poland, Russia and Ukraine. In FY 99, E&E transferred \$1.5 million to the Office of Micro-enterprise for programs in the E&E region. G administers the Development Credit Authority, which has provided loans to leverage private investment in Bulgaria, Poland and Russia. G also administers training programs, the Global Technology Network for trade facilitation, and the Cooperative Development Program (CDP)

and Cooperative Development Research Program (CDR) through which Israeli assistance is provided in the Central Asian

Republics and Georgia. In addition, G supports the U.S.–Russia Bilateral Commission on health-related activities.

Box 4: How USAID Implements Its Programs

USAID provides assistance through the use of contracts, grants and cooperative agreements (grants with substantial USAID involvement). USAID typically contracts with US or host-country firms for the provision of goods and services. Grants and cooperative agreements are with US private and voluntary organizations (PVOs), universities, host-country or international NGOs, and international organizations. Direct cash transfers or grants to E&E governments will only be made under exceptional circumstances, as a last resort and with due consultation in Washington. USAID also administers transfers to other US Government entities.

A number of assistance mechanisms are tailored to use across the range of strategic objectives.

- Technical assistance is provided to governments, enterprises and NGOs, in areas such as financial management.
- Training -- short and long-term; in-country, in the US, and third-country. For instance, health professionals may be trained in order to train other health professionals in treatment or management techniques.
- Exchanges, like training, to transfer knowledge and experience, as in exchanges of managers of electricity utilities.
- Grants – and often, sub-grants – typically to NGOs to provide services or engage in advocacy activities.
- Loans and equity investments, to promote growth of private enterprises; within this category, micro-credit programs are often provided through grants to US PVOs, or local institutions.
- Commodities, either for institutional support or for humanitarian programs.

Significant complements to services and commodities provided through contracts, grants and cooperative agreements are the information and advice given by USAID personnel, especially through field missions but also by technical experts from the E&E Bureau.

All USAID programs have built-in safeguards to protect the integrity of assistance resources. Contractors and grantees are obliged to monitor and report on their resource management. Assistance to governments is provided through contractors and grantees, in part, to avoid transferring funding to host-country governments.

B. Performance Measurement

Planning and implementation of assistance activities is handled by both field missions and Washington-based operating units. It is at this level that program objectives and performance targets are developed, and program performance is first monitored. [Table 3 summarizes strategic objectives of E&E field missions.] Results Reports and Resource Requests (R4s) are the first line of performance reporting. While the E&E Strategic Framework is tailored to the needs of individual countries and programs, it continues to provide a useful framework for assessing the cumulative performance of E&E programs. Field-based performance reporting is one of many factors informing budget allocations.

The E&E Bureau uses two additional mechanisms for performance assessment. First, the Monitoring Country Progress report tracks country trends using economic performance data from the European Bank for Reconstruction and Development and democratic transition data from Freedom House. This is not a direct measure of the impacts of USAID assistance because it measures variables well beyond USAID's control. Second, performance with respect to E&E Strategic Framework is now being assessed with respect to performance criteria and notional graduation thresholds (Annex B). Through this approach, the performance of all SOs is compared in a consistent manner across the entire E&E region. These criteria were applied for the first time in FY 99 and are still under development. They are used to inform decisions on country program graduation and country-level program priorities, but are not meant to dictate when assistance must end.

Consistent with the Monitoring Country Progress findings (summarized in Part I), the Bureau framework criteria identify countries that are consolidating economic, political and social transitions; countries that have embarked on significant reforms but still face a difficult road ahead; and those that are at the earliest reform stages. The first set of countries, most CEE Northern Tier countries, have graduated from USAID assistance or will do so in FY 2000. These are the countries that will be the first to benefit from newly developed legacy mechanisms. The middle group faces a diverse set of issues but is largely expected to satisfy graduation criteria for most strategic objectives during the next five to ten years. Among the countries with the least progress to date, some are likely to make considerable progress during the next five to ten years. Prospects are more guarded for countries -- such as Belarus, Turkmenistan and Uzbekistan -- that have been more recalcitrant.

In summary, within seven to ten years, fewer E&E countries are expected to require assistance, each country's residual assistance needs should be in fewer strategic objective areas, and the nature of bilateral relationships should change to reflect increased in-country capacity.

**Table 3: USAID Strategic Objectives in Eurasia and Europe
FY1999**

	<i>Economic Restructuring</i>						<i>Democratic Transition</i>			<i>Social Transition</i>		
EURASIA	1.1	1.2	1.3	1.4	1.5	1.6	2.1	2.2	2.3	3.1	3.2	3.4
Armenia												
Azerbaijan												
Belarus												
Georgia												
Kazakhstan												
Kyrgyzstan												
Moldova												
Russia												
Tajikistan												
Turkmenistan												
Ukraine												
Uzbekistan												
EURASIA--TOTAL #	3	8	11	8	9	7	11	4	4	5	5	0
EUROPE	1.1	1.2	1.3	1.4	1.5	1.6	2.1	2.2	2.3	3.1	3.2	3.4
Albania												
Bosnia-Herzegovina												
Bulgaria												
Croatia												
FYR Macedonia												
Hungary												
Latvia												
Lithuania												
Poland												
Romania												
Slovakia												
FR of Yugoslavia												
EUROPE--TOTAL #	0	2	7	8	3	1	8	1	6	2	2	2

<i>Key</i>	
SO#	Statement of Objective
1.1	Privatization
1.2	Fiscal Reform
1.3	Strengthening Private Enterprises
1.4	Financial Sector Reform
1.5	Sustainable Energy Systems
1.6	Environmental Management
2.1	Citizen Participation
2.2	Rule of Law
2.3	Local Governance
3.1	Reduced Human Suffering
3.2	Health
3.4	Mitigating Social Impacts

<i>Notes</i>
1. In FY1999, USAID was pursuing Strategic Objectives 1.5 and 1.6 on a regional basis in the Central Asian countries.
2. The designation SO 3.3 is reserved for certain environmental health activities initiated prior to Fiscal Year 1999, to facilitate accounting and reporting.
3. The designations SO 4.1, for Special Initiatives, and SO 4.2 for Cross-cutting Programs, are used throughout the E&E Region for such programs as Health Partnerships, Eurasia Foundation, Enterprise Funds, and Regional Initiatives.

From Transition to Partnership
**Strategic Framework for USAID Programs
in Europe and Eurasia**

ANNEX A:
Management Considerations

A. Resource Requirements

Program Budgets

The E&E Strategy has to maintain flexibility in the face of changing circumstances and uncertain funding levels. Historically, E&E program budgets have fluctuated widely, responded to extensive Congressional earmarking and directives, and, in the case of the Freedom for Russia and the Emerging Eurasian Democracies

(FREEDOM) Support Act (FSA), accommodated increased transfers to other US Government Departments and Agencies. Annual funding levels for Europe and Eurasia are presented in Figure 5. Support for East European Democracies (SEED) Act levels declined from FY 96 to 98 as Northern Tier countries approached graduation. FY 99 SEED levels reflect supplemental appropriations for humanitarian support to Kosovo and Southeastern Europe. FSA levels peaked in FY 94. In recent

Figure 5: Total Funding

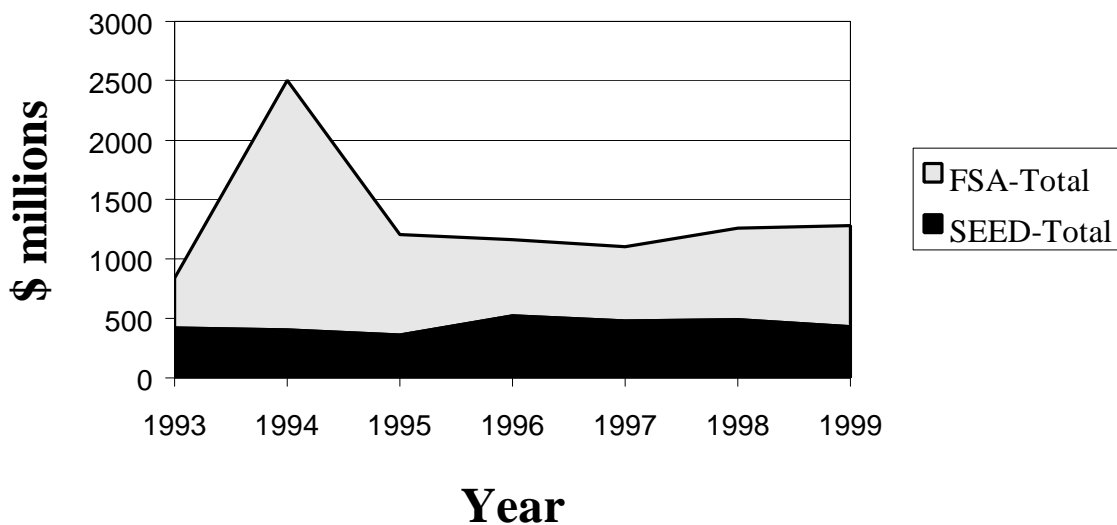
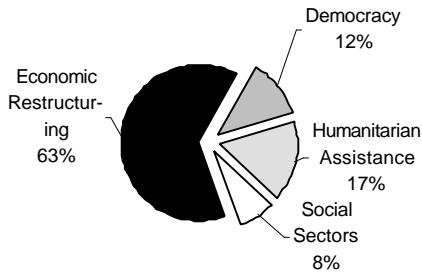


Figure 6: Cumulative USAID Budget Support for Eurasia, FY 95 - FY 99

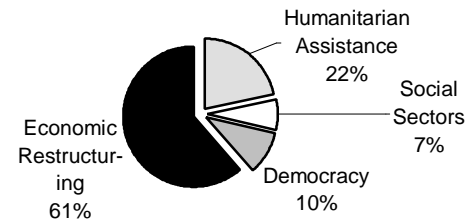


years, FSA appropriations have contained substantial earmarks and directives for Armenia, Georgia and Ukraine. Transfers to other agencies have increased, from 26 percent in FY 96 to 39 percent in FY 99, for energy, security and other programs. The E&E Bureau also administers Economic Support Fund programs in Cyprus and Ireland.

The E&E Strategy as presented herein assumes, at a minimum, funding levels that are consistent with recent patterns. Funding requirements for Central and Eastern Europe will exceed \$700 million in FYs 2000 and 2001, reflecting extraordinary needs in Southeast Europe, and decline incrementally over the next three to five years before stabilizing in the range of \$500 million.

Although, since 1996, Bosnia has enjoyed funding levels of between \$180 and \$225 million -- as part of the U.S. Government's support of the Dayton Accords to promote ethnic reconciliation, minority returns and economic recovery from war -- Bosnia's levels are expected to decline in FY 2000 and beyond as major funding needs in Kosovo absorb the greatest share of the SEED budget. Funding requirements for Eurasia are likely to stabilize in the

Figure 7: Cumulative USAID Budget Support for Europe, FY 90 - 99

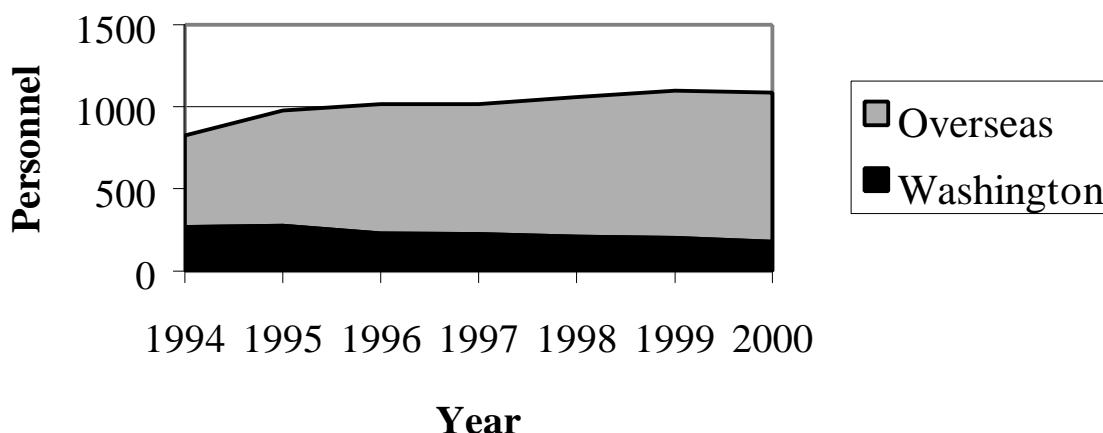


range of \$700 to \$800 million (exclusive of the Enhanced Threat Reduction Initiative), with inter-agency transfers remaining below 40 percent.

Allocation of USAID's discretionary funding by sector and program is done largely at the Mission level, in consultation with USAID Washington and the State Department. Congressional earmarks and directives, and Administration foreign policy priorities, also drive sectoral allocation outcomes. Historically (Figures 6 and 7), social transition, exclusive of emergency humanitarian assistance, has received eight percent of total funding for E&E programs. The E&E Bureau expects a substantial increase in the share of funds allocated to non-emergency, social transition programs.

Lower funding levels would seriously compromise the ability of USAID to carry out many of the programs described in this document. Partnership and post-presence-legacy programs have modest funding requirements but would be particularly vulnerable to cuts. The E&E Bureau will seek to protect core programs of this nature. Funding shortfalls would also increase the difficulties in balancing critical social transition concerns with continuing

**Figure 8: Total On-Board Staff In Bureau
for Europe and Eurasia, as of 9/30**



support for economic and political transition. Funding shortfalls would have the greatest impact on programs and countries not protected by earmarks; these are likely to include Bosnia, Russia, Belarus, Moldova and the Central Asian Republics, as well as reform of health care systems, energy programs and agricultural development. Conversely, additional funding would enable the E&E Bureau to extend partnership activities more broadly throughout the region, strengthen regional programs, and accelerate efforts to address the social underpinnings of successful transition.

Staffing and Operating Expenses

Under the best of circumstances, over the next two years, the Bureau's OE-funded staff levels will increase marginally, or more realistically, remain at FY 2000 levels. This means that overseas, U.S. direct-hire (USDH) staff

will be 120, or 17 percent less than the Bureau's FY 2000 request level. In Washington, USDH staff is expected to decline by 15 percent, from the FY 1999 level of 129 to 110 in FY 2000. While USDH staff levels are predicted to decline, SEED-funded program funding requirements are expected to reach \$700 million in FY 2000 and 2001, a 63 percent increase over the FY 1999 pre-supplemental level of \$430 million.

The use of program funds for operating purposes must be considered judiciously and prudently. Legal and policy requirements delimit the use of program funds for operations, in general requiring OE funding for functions which are inherently governmental. In addition, there are real trade-offs between using these funds for management and administration versus program implementation. Over a 4-year period, from FY 1995 to FY 1999, the number of program-funded staff in the field went

up by 106 percent, from 159 to 327; OE-funded staff in the field increased by 5 percent. Although program levels remained fairly stable during this period, the devolution of budget and program authority to the field to improve program effectiveness resulted in increases in field staff, beginning in FY 1995. Indeed, in Washington, total staff levels declined by almost 35 percent during the same period. It may be that the Bureau has reached or approached the level of program funding for operating purposes that is prudent and appropriate, and that few additional savings can be expected here.

It is highly likely that in seven or ten years, fewer staff overall will be required, if the Bureau achieves the objectives of graduating more countries, focusing program resources on a reduced number of strategic objective areas, and developing in-country capacity to implement a large bulk of Bureau programs. However, there are no additional graduation dates scheduled beyond the Northern Tier at this time.

B. Achieving Efficiencies in the Use and Management of Staff and Program Resources

Many of the lessons learned by the Bureau over the last ten years imply the need for greater resources, both program and human, to achieve the Bureau's objectives in the region. These lessons include recognition: that the timeframe of the transition process needs to be extended in some countries; that developing institutional capacity is fundamental to sustainability; that the social dimension of the transition process is required to expand the reach of its benefits; and that local

development is key to delivering the benefits of reform to a greater number of people. Ultimately, however, the human and financial resources of the Bureau are limited. During the last few years, the E&E Bureau has developed and launched a number of initiatives to achieve greater efficiencies in the use and management of such. Other, potential interventions have been identified. Examples of such initiatives include the following:

- **Organizational Initiatives:** The Bureau has reorganized to take better advantage of economies of scale. Specifically, the Bureau has established regional missions in Eurasia, a Regional Support Center in Budapest for countries in Europe, and Washington-based sources of specialized technical services, and program and activity-level support for field posts overseas. The Bureau has also formed a number of working groups to ensure that crosscutting concerns – such as rule of law, anti-corruption, local development and gender equity -- are addressed throughout the portfolio.
- **Procurement Policy:** A procurement planning process has been established which has effectively redistributed the procurement workload throughout the fiscal year. The E&E Bureau has introduced the concept of leader/associate grants and cooperative agreements to reduce the procurement workload. This approach is now being adopted by the Global Bureau for Agency-wide application. In the future, the E&E Bureau needs to gain a better understanding of the appropriate uses

of alternative procurement instruments. The E&E Bureau needs to exercise greater discipline in reducing the number of procurement actions by bundling related activities, and making judicious use of “umbrella” grants, cooperative agreements, and contracts. Where appropriate, the Bureau needs to rely more heavily on the Global Bureau’s procurement instruments to obtain the technical services required.

- **Financial Management:** A Bureau-wide financial reporting database has been developed which allows the Bureau to manage activity pipelines more effectively. This also has enabled the Bureau to reduce the amount of time it takes to deobligate unliquidated funds, which, in turn, has allowed the Bureau to utilize such funds to support planned and on-going priority activities.
- **Program Implementation:** The Bureau has begun the process of improving criteria and thresholds for assessing progress toward achievement of E&E Bureau strategic objectives. The Bureau has devolved Cognizant Technical Officers (CTO) authority to the field to bring activity management closer to where the action takes place. The Bureau has initiated activity management and procurement-related training activities to improve the effectiveness of Bureau activity managers in carrying out their role as CTOs. The Bureau has significantly increased the use of FAA Section 632(a) transfer agreements with other USG agencies, thereby eliminating USAID’s programmatic and financial oversight of those

activities more appropriately implemented by such agencies. In the future, the Bureau needs to exercise greater discipline in focussing on a limited number of strategic objectives in each country, using the principle of comparative advantage. Related to this, the Bureau needs to eliminate unnecessary redundancies in program implementation by coordinating more closely with other donors and USG agencies in program planning. The Bureau needs to explore ways in which information technology can facilitate implementation of Bureau programs across sectors. In addition, the Bureau’s operating units need to utilize instruments that require less direct management involvement – such as grants and cooperative agreements – and to understand better the concept of “substantial involvement” in cooperative agreements, to avoid micromanaging implementers under the pretext of ensuring the achievement of results.

**United States Agency for International Development
Bureau for Europe and Eurasia**

From Transition to Partnership
**Strategic Framework for USAID Programs
in Europe and Eurasia**

ANNEX B:
Transition Assessments
by Strategic Objective and by Country

Strategic Objective 1.1

State-owned assets are being transferred to the private sector at an acceptable rate

	Small Scale Privatization (1-4, 4=best)	Large Scale Privatization (1-4, 4=best)	Freedom House Privatization (1-7, 1=best)	POT 1.1 Score (1-13, 13=best)	Overall Rating (1-10, 10=best)
Hungary	4.0	4.0	1.5	12.5	9.6
Czech Republic	4.0	4.0	2.0	12.0	9.3
Estonia	4.0	4.0	2.0	12.0	9.3
Lithuania	4.0	3.0	2.3	10.8	8.3
Poland	4.0	3.0	2.3	10.8	8.3
Slovakia	4.0	4.0	3.3	10.8	8.3
Latvia	4.0	3.0	2.5	10.5	8.1
Slovenia	4.0	3.0	2.5	10.5	8.1
Russia	4.0	3.0	3.3	9.8	7.6
Croatia	4.0	3.0	4.0	9.0	7.0
FYR Macedonia	4.0	3.0	4.0	9.0	7.0
Georgia	4.0	3.0	4.0	9.0	7.0
Kazakhstan	4.0	3.0	4.3	8.8	6.8
Kyrgyzstan	4.0	3.0	4.3	8.8	6.8
Armenia	3.0	3.0	3.8	8.3	6.4
Albania	4.0	2.0	4.0	8.0	6.3
Bulgaria	3.0	3.0	4.0	8.0	6.3
Moldova	3.0	3.0	4.0	8.0	6.3
Romania	3.0	3.0	4.5	7.5	5.9
Ukraine	3.0	2.0	4.5	6.5	5.1
Azerbaijan	3.0	2.0	5.0	6.0	4.8
Uzbekistan	3.0	3.0	6.3	5.8	4.6
Bosnia-Herzegovina	2.0	2.0	5.5	4.5	3.6
Tajikistan	2.0	2.0	6.3	3.8	3.1
Turkmenistan	2.0	2.0	6.8	3.3	2.7
Belarus	2.0	1.0	6.0	3.0	2.5
Northern Tier CEE	4.0	3.5	2.3	11.2	8.7
Southern Europe	3.3	2.7	4.3	7.7	6.0
Eurasia	3.1	2.5	4.9	6.7	5.3
E&E	3.4	2.8	3.9	8.3	6.5

Graduation Threshold:

> 10.0

> 7.8

Note: ~~Small-scale privatization~~ is a composite index that rates the degree of state ownership of small enterprises and the extent to which land is effectively tradable. ~~Large-scale privatization~~ rates the degree of private (non-state) ownership of large-scale enterprise assets, and the effectiveness of corporate governance. The ~~Freedom House privatization~~ indicator evaluates what percentage of GDP comes from private ownership; how developed is the legal framework for privatization; what proportion of agriculture, housing, land, industry, small business, and the service sector are in private hands; what is the extent of insider participation in the privatization process; and to what degree

From Transition to Partnership

Strategic Objective 1.2

Fiscal polices and management are sound

	Fiscal Deficit (1-5, 5=best)	Revenue/GDP (1-5, 5=best)	External Debt (1-5, 5=best)	Tax Policy (1-5, 5=best)	Tax Admin (1-5, 5=best)	Budget (1-5, 5=best)	Pension (1-5, 5=best)	POT 1.2 Score (1-5, 5=best)	Overall Rating (1-10, 10=best)
Estonia	5.0	5.0	5.0	4.0	4.0	4.0	3.0	4.3	8.4
Czech Republic	5.0	5.0	4.0	4.0	4.0	4.0	3.0	4.1	8.1
Slovenia	5.0	5.0	5.0	4.0	4.0	4.0	2.0	4.1	8.1
Poland	5.0	5.0	4.0	4.0	3.0	4.0	3.0	4.0	7.8
Croatia	5.0	5.0	5.0	4.0	3.0	3.0	2.0	3.9	7.4
Latvia	4.0	4.0	5.0	4.0	4.0	3.0	3.0	3.9	7.4
Hungary	2.0	5.0	3.0	4.0	4.0	4.0	4.0	3.7	7.1
Slovakia	4.0	5.0	4.0	4.0	3.0	3.0	2.0	3.6	6.8
FYR Macedonia	5.0	5.0	3.0	3.0	2.0	3.0	2.0	3.3	6.1
Lithuania	3.0	3.0	5.0	3.0	3.0	3.0	2.0	3.1	5.8
Ukraine	2.0	5.0	5.0	3.0	2.0	2.0	2.0	3.0	5.5
Uzbekistan	3.0	4.0	5.0	3.0	2.0	2.0	2.0	3.0	5.5
Moldova	2.0	3.0	4.0	3.0	3.0	3.0	2.0	2.9	5.2
Romania	3.0	3.0	5.0	3.0	2.0	2.0	2.0	2.9	5.2
Turkmenistan	5.0	2.0	5.0	2.0	2.0	2.0	2.0	2.9	5.2
Azerbaijan	4.0	2.0	5.0	2.0	2.0	2.0	2.0	2.7	4.9
Belarus	5.0	1.0	5.0	2.0	2.0	2.0	2.0	2.7	4.9
Kazakhstan	3.0	3.0	3.0	3.0	2.0	2.0	3.0	2.7	4.9
Bulgaria	1.0	4.0	2.0	4.0	2.0	2.0	2.0	2.4	4.2
Kyrgyzstan	2.0	1.0	4.0	3.0	2.0	3.0	2.0	2.4	4.2
Russia	2.0	3.0	5.0	2.0	1.0	2.0	2.0	2.4	4.2
Albania	1.0	1.0	5.0	2.0	2.0	2.0	3.0	2.3	3.9
Armenia	1.0	2.0	4.0	2.0	2.0	2.0	2.0	2.1	3.6
Bosnia-Herzegovina	...	...	...	2.0	2.0	2.0	2.0	2.0	3.3
Georgia	2.0	1.0	4.0	2.0	1.0	2.0	2.0	2.0	3.3
Tajikistan	2.0	1.0	5.0	1.0	1.0	2.0	2.0	2.0	3.3
Northern Tier CEE	4.1	4.6	4.4	3.9	3.6	3.6	2.8	4.1	8.0
Southeast Europe	3.0	3.6	4.0	3.0	2.2	2.3	2.2	3.2	5.8
Eurasia	2.8	2.3	4.5	2.3	1.8	2.2	2.1	2.8	4.9
E&E	3.2	3.3	4.4	3.0	2.5	2.7	2.3	3.3	6.1

Graduation Threshold

> 4.0

> 7.8

Note: Among the three quantifiable indicators, **fiscal deficit** rates fiscal balance as a % of GDP (3% or lower for three years is seen as sustainable); **revenue/GDP** assesses how appropriate the size of government (35-40% of GDP is seen as the target range); and **external debt** evaluates debt as % of GNP, as a proxy to judge the degree of country indebtedness. Data for these three indicators is derived from IMF statistics. For these quantifiable measures, POT 1.3 defines graduation readiness as three or more years at a level of 4.0 (out of 5.0) or higher.

The four subjective indicators include tax policy, which evaluates 10 factors including fairness of the tax system, establishment of reasonable rates conducive to private investment, and reduction of tax evasion; tax administration assesses 10 criteria, including complete reorganization of tax administration along functional lines, establishment of a single taxpayer number, and existence of transparent and clear procedures to enhance compliance and tracking down of non-filers; budget formulation and execution rates according to 10 criteria, including existence of a treasury system, comprehensive budget law, and capacity for budget analysis; pension reform evaluates 10 factors, among which are existence of a pension policy that describes reforms that will lead to fiscal sustainability, equity, reliability, and efficiency in the pension system. These ratings are prepared on the basis of field visits and reports by USAID-funded implementors.

Strategic Objective 1.3

Private enterprises are growing and developing at an accelerating rate

	Legal and Regulatory Reforms (1-5, 5=best)	Association Development (1-5, 5=best)	TA/Training BSOs (1-5, 5=best)	Education for Entrepreneurs (1-5, 5=best)	Privatization (large/small scale) (1-5, 5=best)	Financial Services (1-5, 5=best)	Macro Indicators (1-5, 5=best)	OVERALL AVERAGE (1-10, 10=best)
Estonia	3.2				4.5	3.2	5.0	7.5
Hungary	3.7				4.5	3.7	3.0	6.9
Czech Republic	3.5				4.5	3.0	3.0	6.6
Lithuania	3.0				3.5	2.7	4.7	6.6
Latvia	3.1				3.5	2.5	4.3	6.4
Slovakia	3.4				4.5	2.5	3.0	6.2
Poland	3.6	2.3	2.6	2.0	4.2	3.1	4.0	6.2
Croatia	2.9				4.0	2.5	3.3	5.8
Slovenia	3.2	2.3	3.0	3.0	4.2	2.7	3.0	5.7
Armenia	2.8	2.0	2.2	2.3	3.0	2.1	5.0	5.4
Albania	2.8				3.0	1.8	3.3	5.0
Bulgaria	2.8	2.3	3.0	1.5	3.0	2.4	3.3	5.0
Georgia	2.8	2.0	2.2	2.0	3.7	1.9	3.7	4.9
Azerbaijan	2.3				2.5	1.8	4.0	4.8
FYR Macedonia	2.5				3.5	2.3	2.7	4.8
Romania	2.8	3.3	2.8	2.7	2.7	2.2	2.7	4.7
Kazakhstan	2.8	2.0	2.2	2.0	3.5	2.3	3.0	4.7
Moldova	2.8	2.3	2.3	2.0	3.2	2.3	3.0	4.7
Kyrgyzstan	2.8	2.0	2.2	2.0	3.5	2.4	2.7	4.6
Ukraine	2.4	3.0	3.0	2.3	2.8	2.0	1.3	3.9
Russia	2.3	3.0	2.7	2.3	3.7	1.9	1.0	3.8
Bosnia-Herzegovina	1.9				2.0	1.5	5.0	3.7
Uzbekistan	1.9	2.0	2.0	2.0	2.8	1.9	1.7	3.2
Tajikistan	2.1	1.0	1.0	1.0	2.2	1.2	2.7	2.7
Turkmenistan	1.4	1.0	1.0	1.0	1.8	1.2	3.7	2.7
Belarus	1.5	1.7	2.0	1.0	1.5	1.3	2.3	2.5
graduation threshold								5.5

Note: The criteria used to assess readiness to graduate in SO 1.3 include both quantitative, macroeconomic indicators, as well as subjective measurements of the private enterprise environment. **Legal and Regulatory Reforms** consists of Governance/Restructuring, Price Liberalization, Trade/Foreign Exchange, and Competition Policy reforms as evaluated by the EBRD. **Association Development, TA/Training for Enterprises** (including BSO Development & Government SME Support Organization), and **Education for Entrepreneurs** are subjective assessments carried out by technical experts in USAID missions in the E&E regions. **Privatization** includes EBRD ratings of progress in both small-scale and large-scale privatization. **Financial Services** includes Banking Reform and Interest Liberalization (from EBRD), Securities Market & Non-Banking sectors (EBRD), and Credit and Services for SMEs/Micro-Enterprises (USAID). **Macro Indicators** included the extent to which GDP growth has been sustained over the past five years, foreign direct investment per capita, and enterprise subsidies as % of GDP.

Strategic Objective 1.4

The private financial sector is increasingly competitive and market-responsive

	Banking Sector Status (1-5, 5=best)	Capital Markets Status (1-5, 5=best)	Overall Rating <i>banking x 2, capmkt x 1</i> (1-10, 10=best)
Hungary	3.7	5.0	8.0
Poland	3.3	5.0	7.5
Czech Republic	3.0	5.0	7.0
Estonia	3.0	5.0	7.0
Latvia	3.0	5.0	7.0
Slovakia	2.7	5.0	6.5
Slovenia	3.0	4.0	6.3
Croatia	3.0	2.0	4.8
Romania	2.0	4.0	4.8
Bulgaria	2.3	3.0	4.5
Kazakhstan	2.3	3.0	4.5
Kyrgyzstan	2.3	3.0	4.5
Lithuania	2.3	3.0	4.5
Russia	1.7	4.0	4.2
Moldova	2.0	3.0	4.0
Ukraine	1.7	3.0	3.5
Armenia	2.0	2.0	3.3
FYR Macedonia	2.0	2.0	3.3
Georgia	2.0	2.0	3.3
Bosnia-Herzegovina	2.0	1.0	2.5
Uzbekistan	2.0	1.0	2.5
Azerbaijan	1.0	2.0	1.8
Albania	1.3	1.0	1.5
Belarus	1.0	1.0	1.0
Tajikistan	1.0	1.0	1.0
Turkmenistan	1.0	1.0	1.0
Northern Tier CEE	3.0	4.6	6.7
Southeast Europe	2.1	2.2	3.5
Eurasia	1.7	2.2	2.9
E&E	2.2	2.9	4.2
Graduation Threshold:	> 3.0	> 3.0	> 5.5

~~Note:~~ Both graduation criteria for SO 1.4 are subjective indicators evaluated by POT 1.4. ~~Capital markets~~ rates the extent to which component institutions are in place; the development of financial intermediaries and professional participants; whether issuers operate in a fair transparent manner vis-a-vis shareholders and the market; the degree to which there is broad participation in a liquid securities market; and the development of capital formation capacity. The ~~Banking Sector~~ indicator evaluates the extent of private ownership of the banking sector; whether the banking system is sound, regulated, and efficient; the growth of credit to non-

Strategic Objective 1.5

The energy sector is economically sound and environmentally sustainable

	Pricing (1-5, 5=best)	Efficiency (1-5, 5=best)	Restructuring Privatization (1-5, 5=best)	Nuclear Safety (1-5, 5=best)	Regional Trade (1-5, 5=best)	POT 1.5 Score (1-5, 5=best)	Overall Rating (1-10, 10=best)
Hungary	5.0	5.0	4.3	5.0	5.0	4.9	9.7
Czech Republic	4.0	4.0	3.0	5.0	5.0	4.2	8.2
Poland	4.0	4.0	3.0	...	4.0	3.8	7.2
Latvia	5.0	3.3	3.0	...	3.0	3.6	6.8
Romania	4.0	2.3	3.0	4.0	3.0	3.3	6.1
Georgia	4.0	2.0	3.0	...	3.0	3.0	5.5
FYR Macedonia	4.0	2.0	2.0	...	3.0	2.8	4.9
Kazakhstan	3.0	2.0	3.0	...	3.0	2.8	4.9
Moldova	4.0	2.0	3.0	...	2.0	2.8	4.9
Armenia	4.0	3.0	3.0	2.0	1.0	2.6	4.6
Lithuania	3.0	2.0	3.0	2.0	3.0	2.6	4.6
Slovakia	2.0	2.0	2.0	3.0	4.0	2.6	4.6
Ukraine	3.0	2.0	3.0	3.0	1.0	2.4	4.2
Bulgaria	3.0	2.3	2.0	2.0	2.0	2.3	3.8
Russia	2.0	2.0	3.0	2.0	2.0	2.2	3.7
Kyrgyzstan	1.0	1.0	2.0	...	3.0	1.8	2.7
Albania	...	...	...	...	...	...	...
Azerbaijan	...	...	...	...	...	...	...
Belarus	...	...	...	...	...	...	...
Bosnia-Herzegovina	...	...	...	...	...	...	...
Croatia	...	...	...	...	...	...	...
Estonia	...	...	...	...	...	...	...
Serbia	...	...	...	...	...	...	...
Slovenia	...	...	...	...	...	...	...
Tajikistan	...	...	...	...	...	...	...
Turkmenistan	...	...	...	...	...	...	...
Uzbekistan	...	...	...	...	...	...	...
Northern Tier CEE	3.8	3.4	3.1	3.8	4.0	3.6	6.9
Southeast Europe	3.7	2.2	2.3	3.0	2.7	2.8	5.0
Eurasia	3.0	2.0	2.9	2.3	2.1	2.5	4.3
E&E	3.4	2.6	2.8	3.1	2.9	3.0	5.4

Graduation Threshold: standard for graduation was set by Hungary in 1998, at approx. 4.9

> 4.9

> 9.8

Note: POT 1.5 provided the overall assessments of graduation readiness on the basis of the following indicators. **Pricing** describes the extent to which government subsidies for energy commodities have been eliminated, and whether a national energy policy has been adopted by the cabinet or parliament. **Efficiency** rates each country's progress in reducing the energy intensity of its economy, and whether significant investments have been made in emissions control technologies. Progress in demonopolizing the power, gas, and petroleum sectors and in establishing commercial companies with majority strategic private ownership is reflected in the **Restructuring** indicator. **Nuclear Safety** rates progress in carrying out in-depth safety assessments and upgrading high-risk plants with improved equipment, and whether an independent nuclear regulatory commission has been established. **Regional Trade** reflects the development of electrical connections with Western Europe and international markets, and shows the level of energy import diversification.

Strategic Objective 1.6

Environmental management capacity supports sustainable economic growth

	Policy, Legal, Regulatory IR 1.6.1 (1-5, 5=best)	Env. Trade & Investment IR 1.6.2 (1-5, 5=best)	Best Practices Adopted IR 1.6.3a/b (1-5, 5=best)	Ident. Env. Prob./ Particip. of NGOs IR 1.6.4/1.6.5 (1-5, 5=best)	POT 1.6 Score (1-5, 5=best)	Overall Rating (1-10, 10=best)
Poland	3.5	3.3	...	3.8	3.5	6.6
Czech Republic	3.3	3.3	...	4.0	3.5	6.6
Hungary	3.5	3.3	...	3.8	3.5	6.6
Slovenia	3.0	3.0	...	3.3	3.1	5.7
Lithuania	2.8	3.0	...	3.3	3.0	5.5
Estonia	2.8	3.0	...	3.0	2.9	5.3
Latvia	2.8	2.8	...	3.0	2.8	5.1
Slovakia	2.8	2.5	...	3.0	2.8	4.9
Bulgaria	3.0	2.3	...	2.8	2.7	4.8
Croatia	2.3	2.5	...	2.5	2.4	4.2
Romania	2.8	2.3	...	2.3	2.4	4.2
Russia	2.3	2.5	...	2.3	2.3	4.0
FYR Macedonia	2.8	2.0	...	2.3	2.3	4.0
Ukraine	2.0	2.3	...	2.5	2.3	3.8
Moldova	2.3	2.0	...	2.3	2.2	3.6
Kyrgyzstan	2.0	1.8	...	2.3	2.0	3.3
Armenia	1.8	2.0	...	2.3	2.0	3.3
Kazakhstan	2.0	1.8	...	2.3	2.0	3.3
Belarus	1.8	1.3	...	2.0	1.7	2.5
Uzbekistan	1.5	1.3	...	2.0	1.6	2.3
Turkmenistan	1.5	1.3	...	1.5	1.4	1.9
Bosnia-Herzegovina	1.3	1.5	...	1.3	1.3	1.8
Georgia	1.0	1.3	...	1.5	1.3	1.6
Tajikistan	1.0	1.3	...	1.3	1.2	1.4
Albania	1.0	1.3	...	1.3	1.2	1.4
Azerbaijan	1.0	1.0	...	1.0	1.0	1.0
Northern Tier CEE	3.0	3.0	...	3.4	...	...
Southeast Europe	2.2	2.0	...	2.0	...	...
Eurasia	1.7	1.6	...	1.9	...	...
E&E	2.2	2.1	...	2.4	...	...

Graduation Threshold:

> 3.0

> 5.5

Note: Graduation criteria for SO 1.6 are subjective, and are assessed by POT 1.6. **Policy/Legal/Regulatory** evaluates whether a clear national statement of environmental objectives exists, and the extent to which legislation, policies, and regulations have been established and contribute to meeting each environmental objective. **Environmental Trade & Investment** reflects the degree to which a genuine market for environmental goods and services exists and is growing, and the level of government effort to leverage private finance to meet the demand for environmental investments. **Best Practices/Natural Resources** rates the extent to which environmental management systems are improving environmental performance, whether monitoring systems are used for measuring and reporting industrial environmental performance to the public. The degree of environmental NGOs and citizen group involvement in advancing local or national environmental objectives is captured by the **NGO** indicator.

Strategic Objective 2.1

Informed citizens participate actively in political and economic decision-making

	NGO Sustainability (1-7, 1=best)	Media (1-7, 1=best)	Political Process (1-7, 1=best)	POT 2.1 Score (1-7, 1=best)	Overall Rating (1-10, 10=best)
Hungary	2.0	1.0	1.0	1.3	9.5
Poland	2.0	1.0	1.0	1.3	9.5
Czech Republic	2.0	2.0	1.0	1.7	9.0
Estonia	2.0	2.0	2.0	2.0	8.5
Lithuania	3.0	2.0	1.0	2.0	8.5
Latvia	3.0	2.0	2.0	2.3	8.0
Slovakia	3.0	3.0	3.0	3.0	7.0
Romania	4.0	3.0	3.0	3.3	6.5
Russia	3.0	4.0	3.0	3.3	6.5
Bulgaria	4.0	4.0	3.0	3.7	6.0
FYR Macedonia	4.0	4.0	4.0	4.0	5.5
Kyrgyzstan	4.0	4.0	4.0	4.0	5.5
Moldova	4.0	4.0	4.0	4.0	5.5
Croatia	4.0	5.0	4.0	4.3	5.0
Georgia	4.0	5.0	4.0	4.3	5.0
Ukraine	4.0	5.0	4.0	4.3	5.0
Armenia	5.0	4.0	5.0	4.7	4.5
Kazakhstan	4.0	5.0	5.0	4.7	4.5
Albania	4.0	6.0	5.0	5.0	4.0
Azerbaijan	6.0	5.0	5.0	5.3	3.5
Bosnia-Herzegovina	6.0	5.0	5.0	5.3	3.5
Uzbekistan	5.0	5.0	6.0	5.3	3.5
Serbia & Montenegro	5.0	6.0	6.0	5.7	3.0
Belarus	6.0	6.0	6.0	6.0	2.5
Tajikistan	7.0	5.0	6.0	6.0	2.5
Turkmenistan	7.0	7.0	7.0	7.0	1.0
Slovenia	...	...	...	...	...
Northern Tier CEE	2.4	1.9	1.6	8.7	2.4
Southeast Europe	4.4	4.7	4.3	10.9	1.7
Eurasia	4.9	4.9	4.9	10.9	1.7
E&E	4.1	4.0	3.8	10.3	1.9

Graduation Threshold:

< 3.0

>7.0

Notes: ~~NGO Sustainability~~ is assessed annually by POT 2.1 in their *NGO Sustainability Index*, and reflects development in the four key areas of Legal Environment, Organizational Capacity, Financial Viability, and Advocacy. The assessment of ~~Media~~ is also conducted in-house, and reflects the extent to which media legislation conforms to EU standards, with free and fair competition for broadcast rights; whether each major town in the E&E region has access to private non-governmental self-sustaining television and radio station, and at least one non-state newspaper; and whether journalism associations develop and sustain professional standards. ~~Political Process~~ rates each country on success in establishing open and transparent elections according to internationally accepted standards as the basis for achieving political power, and is also conducted by POT 2.1.

Strategic Objective 2.2

Legal systems support democratic processes and market reforms

	Independent Judiciary			Rule of Law Rating		OVERALL POT ASSESSMENT*
	1997	1998	POT evaluation (1-5, 5=best)	Freedom House (1 to 7, 1=best)	POT evaluation (1-5, 5=best)	Rule of Law & Independent Judiciary (1-10, 10=best)
Czech Republic	yes	yes	5.0	1.5	4.7	9.5
Poland	yes	yes	5.0	1.5	4.7	9.5
Slovenia	yes	yes	5.0	1.5	4.7	9.5
Hungary	yes	yes	5.0	1.8	4.5	9.3
Lithuania	yes	yes	5.0	2.0	4.3	9.0
Estonia	yes	yes	5.0	2.3	4.2	8.8
Latvia	yes	yes	5.0	2.3	4.2	8.8
Bulgaria	yes	yes	5.0	3.8	3.2	7.3
FYR Macedonia	yes	yes	5.0	4.5	2.7	6.5
Slovakia	yes	no	3.0	4.0	3.0	5.5
Ukraine	no	no	1.0	4.0	3.0	4.0
Romania	no	no	1.0	4.3	2.8	3.8
Russia	no	no	1.0	4.3	2.8	3.8
Kyrgyzstan	no	no	1.0	4.5	2.7	3.5
Moldova	no	no	1.0	4.5	2.7	3.5
Armenia	no	no	1.0	4.8	2.5	3.3
Croatia	no	no	1.0	4.8	2.5	3.3
Georgia	no	no	1.0	5.0	2.3	3.0
Serbia-Montenegro	no	no	1.0	5.0	2.3	3.0
Albania	no	no	1.0	5.3	2.2	2.8
Kazakhstan	no	no	1.0	5.3	2.2	2.8
Azerbaijan	no	no	1.0	5.5	2.0	2.5
Belarus	no	no	1.0	6.0	1.7	2.0
Tajikistan	no	no	1.0	6.0	1.7	2.0
Bosnia-Herzegovina	no	no	1.0	6.5	1.3	1.5
Uzbekistan	no	no	1.0	6.5	1.3	1.5
Turkmenistan	no	no	1.0	6.8	1.2	1.3

From Transition to Partnership

Note: Independent Judiciary ratings are from the U.S. Department of State *Report on Human Rights Practices* 1997 and 1998. Rule of Law Rating is from Freedom House *Nations in Transit* 1998, on a scale of one to seven with one being the most advanced in terms of democratic legal systems. The Rule of Law indicator is double-weighted in the overall average.

Strategic Objective 2.3

Local government is effective, responsive, and accountable

	Legal Sustainability (1-90, 90=best)	Democratic Process (1-90, 90=best)	Financial Resources (1-90, 90=best)	Municipal Services (1-90, 90=best)	Institutional Support (1-90, 90=best)	POT 2.3 Score (5-450, 450=best)	Overall Rating (1-10, 10=best)
Czech Republic	75	68	75	60	75	353	8.0
Poland	75	75	75	53	75	353	8.0
Hungary	60	75	60	60	53	308	7.1
Bulgaria	45	45	15	45	45	195	4.8
Romania	60	45	15	30	45	195	4.8
Slovakia	45	15	30	45	45	180	4.5
Ukraine	30	38	15	30	30	143	3.8
Armenia	30	30	15	15	38	128	3.5
Yugoslavia	15	30	15	45	15	120	3.3
Kyrgyzstan	23	23	15	15	30	105	3.0
FYR Macedonia	30	15	15	23	15	98	2.9
Moldova	30	23	15	15	15	98	2.9
Kazakhstan	15	15	15	30	15	90	2.7
Albania	23	15	15	15	15	83	2.6
Azerbaijan	...	...	...	...	...	...	...
Belarus	...	...	...	...	...	...	...
Bosnia-Herzegovina	...	...	...	...	...	...	...
Croatia	...	...	...	...	...	...	...
Estonia	...	...	...	...	...	...	...
Georgia	...	...	...	...	...	...	...
Latvia	...	...	...	...	...	...	...
Lithuania	...	...	...	...	...	...	...
Russia	...	...	...	...	...	...	...
Slovenia	...	...	...	...	...	...	...
Tajikistan	...	...	...	...	...	...	...
Turkmenistan	...	...	...	...	...	...	...
Uzbekistan	...	...	...	...	...	...	...
Northern Tier CEE	64	58	60	54	62	60	2.1
Southeast Europe	35	30	15	32	27	28	1.5
Eurasia	26	26	15	21	26	23	1.4
E&E	40	36	28	34	36	35	1.6
Graduation Threshold		Country has largely met this strategic objective			>	300	7.0
		More time is needed before reforms are sustainable			>	150	3.9
		Reform efforts in this SO have been slow or non-existent			>	5	1.0

Note: These ratings represent the subjective assessments of POT 2.3 across the five graduation criteria. POT evaluations were originally on a high-medium-low scale, and were converted to a numerical values for the purpose of this POT synthesis. **Legal Sustainability** assesses whether local officials are elected in a free and fair manner, and the extent to which local government authority is legally guaranteed. **Democratic Process** reflects the degree to which such mechanisms as open debate on municipal budget, open hearings and town meetings are adopted, and whether citizens participate and are involved in local governance. **Financial Resources** evaluates whether the system of intergovernmental transfers is predictable, fair, timely, and transparent, and the extent to which cities raise their own revenue. **Municipal Services and Assets** rates the extent of private ownership of the housing stock and commercial enterprises. **Institutional Support Systems** indicates the level of development of a network of viable, independent institutions engaged in addressing local government reform.

Graduation Readiness in Eurasia

1-10 scale

Statement of Objective		Armenia	Azerbaijan	Belarus	Georgia	Kazakhstan	Kyrgyzstan	Moldova	Russia	Tajikistan	Turkmenistan	Ukraine	Uzbekistan	Eurasia Average
I.	Economic Restructuring and Growth													
1.1	State-owned assets are being transferred to the private sector at an acceptable rate	6.4	4.8	2.5	7.0	6.8	6.8	6.3	7.6	3.1	2.7	5.1	4.6	5.3
1.2	Fiscal policies and management are sound	3.6	4.9	4.9	3.3	4.9	4.2	5.2	4.2	3.3	5.2	5.5	5.5	4.5
1.3	Private enterprises are growing and developing at an accelerating rate	5.4	4.8	2.5	4.9	4.7	4.6	4.7	3.8	2.7	2.7	3.9	3.2	4.0
1.4	The private financial sector is increasingly competitive and market-responsive	3.3	1.8	1.0	3.3	4.5	4.5	4.0	4.2	1.0	1.0	3.5	2.5	2.9
1.5	The energy sector is economically sound and environmentally sustainable	4.6	...	...	5.5	4.9	2.7	4.9	3.7	...	...	4.2	...	4.4
1.6	Environmental management capacity supports sustainable economic growth	3.3	1.0	2.5	1.6	3.3	3.3	3.6	4.0	1.4	1.9	3.8	2.3	2.7
II.	Democracy and Governance													
2.1	Informed citizens participate actively in political and economic decision-making	4.5	3.5	2.5	5.0	4.5	5.5	5.5	6.5	2.5	1.0	5.0	3.5	4.1
2.2	Legal systems support democratic processes and market reforms	3.3	2.5	2.0	3.0	2.8	3.5	3.5	3.8	2.0	1.3	4.0	1.5	2.8
2.3	Local government is effective, responsive, and accountable	3.5	...	...	...	2.7	3.0	2.9	...	...	...	3.8	...	3.2
III.	Social Stabilization													
3.1	Response to and management of humanitarian crises are good													
3.2	The provision of health and other social benefits and services is sustainable													
Overall Average for Each Country (1-10 scale, 10=best)		4.2	3.3	2.6	4.2	4.3	4.2	4.5	4.7	2.3	2.2	4.3	3.3	3.7
ECON (1-10 scale, 10=best)		4.4	3.4	2.7	4.2	4.8	4.3	4.8	4.6	2.3	2.7	4.3	3.6	3.9
D/G (1-10 scale, 10=best)		3.7	3.0	2.3	4.0	3.3	4.0	4.0	5.1	2.3	1.1	4.3	2.5	3.3

From Transition to Partnership

Graduation Readiness in Central and Eastern Europe

1-10 scale

Statement of Objective	Albania	Bosnia-Herzegovina	Bulgaria	Croatia	Czech Republic	Estonia	FYR Macedonia	Hungary	Latvia	Lithuania	Poland	Romania	Serbia & Montenegro	Slovakia	Slovenia	CEE Average
I. Economic Restructuring and Growth																
1.1 State-owned assets are being transferred to the private sector at an acceptable rate	6.3	3.6	6.3	7.0	9.3	9.3	7.0	9.6	8.1	8.3	8.3	5.9		8.3	8.1	7.5
1.2 Fiscal policies and management are sound	3.9	3.3	4.2	7.4	8.1	8.4	6.1	7.1	7.4	5.8	7.8	5.2		6.8	8.1	6.4
1.3 Private enterprises are growing and developing at an accelerating rate	5.0	3.7	5.0	5.8	6.6	7.5	4.8	6.9	6.4	6.6	6.2	4.7		6.2	5.7	5.8
1.4 The private financial sector is increasingly competitive and market-responsive	1.5	2.5	4.5	4.8	7.0	7.0	3.3	8.0	7.0	4.5	7.5	4.8		6.5	6.3	5.4
1.5 The energy sector is economically sound and environmentally sustainable	...	...	3.8	...	8.2	...	4.9	9.7	6.8	4.6	7.2	6.1		4.6	...	6.2
1.6 Environmental management capacity supports sustainable economic growth	1.4	1.8	4.8	4.2	6.6	5.3	4.0	6.6	5.1	5.5	6.6	4.2		4.9	5.7	4.8
II. Democracy and Governance																
2.1 Informed citizens participate actively in political and economic decision-making	4.0	3.5	6.0	5.0	9.0	8.5	5.5	9.5	8.0	8.5	9.5	6.5		7.0	...	7.0
2.2 Legal systems support democratic processes and market reforms	2.8	1.5	7.3	3.3	9.5	8.8	6.5	9.3	8.8	9.0	9.5	3.8		5.5	9.5	6.8
2.3 Local government is effective, responsive, and accountable	2.6	...	4.8	...	8.0	...	2.9	7.1	...	...	8.0	4.8		4.5	...	5.4
III. Social Stabilization																
3.1 Response to and management of humanitarian crises are good																
3.2 The provision of health and other social benefits and services is sustainable																
Overall Average for Each Country (1-10 scale, 10=best)	3.4	2.8	5.2	5.4	8.0	7.8	5.0	8.2	7.2	6.6	7.9	5.1		6.0	7.2	6.1
ECON (1-10 scale, 10=best)	3.6	3.0	4.8	5.8	7.6	7.5	5.0	8.0	6.8	5.9	7.3	5.1		6.2	6.8	6.0
D/G (1-10 scale, 10=best)	3.1	2.5	6.0	4.1	8.8	8.6	5.0	8.6	8.4	8.8	9.0	5.0		5.7	...	6.4

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ANNEX C: Bibliography

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ANNEX D: List of Acronyms

BHR	Bureau for Humanitarian Response (USAID)
CARs	Central Asian Republics
CDP	Cooperative Development Program
CDR	Cooperative Development Research Program
CEE	Central and Eastern Europe
CSO	Civil Society Organization
CTO	Cognizant Technical Officer
E&E	Europe and Eurasia
EBRD	European Bank for Reconstruction and Development
EU	European Union
FDI	Foreign Direct Investment
FSA	Freedom for Russia and the Emerging Eurasian Democracies (FREEDOM) Support Act
FY	Fiscal Year
G	Global Bureau
GDP	Gross Domestic Product
IFI	International Financial Institution
ILO	International Labor Organization (United Nations)
NGO	Non-Governmental Organization
OE	Operating Expenses
OECD	Organization for Economic Cooperation and Development
OSCE	Organization for Security and Cooperation in Europe
PAUCI	Polish-American-Ukrainian Cooperation Initiative
PVO	Private and Voluntary Organization
SAA	Strategic Assistance Areas
SEI	Southeast Europe Initiative
SME	Small and Medium Enterprises
SO	Strategic Objective
UN	United Nations
UNDP	United Nations Development Program
USDH	United States - Direct Hire